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No. 94, Original

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1982

State of South Carolina,

Plaintiff,

vs.

Donald T. Regan, Secretary of the Treasury of the United States of America,

Defendant.

MOTION FOR LEAVE TO FILE COMPLAINT, COMPLAINT AND SUPPORTING BRIEF

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Donald T. Regan, Secretary of the Treasury of the United States of America,

Defendant.

MOTION FOR LEAVE
TO FILE COMPLAINT

Pursuant to Rule 9.3 of the Rules of the Supreme Court of the United States, the plaintiff State of South Carolina respectfully asks leave of the Court to file the Complaint which is submitted herewith for the reasons stated therein and in the attached supporting brief.

T. TRAVIS MEDLOCK
Attorney General

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Chief Deputy Attorney General

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By: Huger Sinkler
ATTORNEYS for Plaintiff.

February 2nd, 1983

*Counsel of Record.

No. _____, Original

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1982

State of South Carolina,

Plaintiff,

vs.

Donald T. Regan, Secretary of the Treasury of the United States of America,

Defendant.

C O M P L A I N T

The plaintiff State of South Carolina ("South Carolina") brings this action in equity against the defendant and for its cause of action states that:

1. The plaintiff is a sovereign State of the United States, is one of the thirteen founding States and is an original party to the compact of sovereign States known as the Constitution of the United States.

2. The defendant is a resident and citizen of Virginia and is the duly appointed,

qualified and acting Secretary of the Treasury of the United States.

3. The original jurisdiction of this Court is invoked under Article III, Section 2 of the Constitution of the United States.

4. As one of its essential sovereign functions and in the course of the exercise of its sovereign responsibility, South Carolina must borrow money to enable it to function effectively as a provider of services essential to the health and welfare of its citizens. By the Tenth Amendment to the Constitution of the United States, South Carolina has been guaranteed the power to borrow money when and as it chooses. Pursuant to Article X, Section 13 of the South Carolina Constitution of 1895, as amended, South Carolina is authorized to borrow money and to issue general obligation and other bonds.

5. On August 19, 1982, the Congress of the United States enacted Public Law 97-248,

the "Tax Equity and Fiscal Responsibility Act of 1982 ("the Act"), and, on September 3, 1982, the President of the United States approved the Act to become effective on January 1, 1983. Section 310(b)(1) of the Act, whose effective date of implementation was subsequently suspended until July 1, 1983, requires that obligations, including State obligations evidencing State borrowing, must be issued in fully registered form in order that interest paid thereon by South Carolina to its lenders remain exempt from federal income taxation, as is manifested by the provisions of Section 310(b)(1), a copy of which is attached hereto, made a part hereof and designated Exhibit A.

6. The defendant as Secretary of the Treasury of the United States is mandated by Title 26, Section 7801 of the United States Code to enforce the provisions of Section 310(b)(1) of the Act.

7. Section 310(b)(1) of the Act

impermissibly imposes conditions upon the power of South Carolina to borrow money for public purposes by requiring that either a State must issue bonds in fully registered form or the interest which it pays upon its borrowings will be subject to federal income taxation and thus unconstitutionally impairs the ability of South Carolina to function effectively as a sovereign in violation of the Tenth Amendment to the Constitution of the United States in that it abridges South Carolina's sovereign right to borrow money by issuing debt obligations in the form that it deems desirable.

8. As is manifested by the affidavit of the State Treasurer of South Carolina, a copy of which affidavit is attached hereto, made a part hereof and designated Exhibit B, South Carolina has throughout its history found it essential to its functions as a sovereign to borrow money, primarily through the issuance of general obligation bonds, and fully intends to continue to issue general obligation bonds after

June 30, 1983, the effective date of Section 310(b)(1) of the Act. The conditions and restrictions imposed upon its borrowing power by the provisions of Section 310(b)(1) of the Act materially infringe upon the exercise of that power, including increasing the cost thereof, as is more fully set forth in Exhibit B.

9. The Congress of the United States has no power whatsoever to impose an income tax upon the interest paid by South Carolina to its lenders. Such tax exemption does not result from the pertinent provisions of Section 103 of the Internal Revenue Code. Those provisions merely recognize the tax exemption which results from the sovereignty of the States in their relationship with the national government. The Sixteenth Amendment to the United States Constitution neither changed nor proposed to change this relationship. If the Congress may tax by direct or indirect means the interest paid by South Carolina on

its borrowings, the result will be the destruction of the federal system.

10. The application of Section 310(b)(1) of the Act to the general obligations of South Carolina causes irreparable injury to South Carolina and results in the destruction of its sovereignty for which there is no remedy at law.

WHEREFORE, the plaintiff prays:

A. That the Court grant the plaintiff's motion for leave to file its complaint and assume original jurisdiction of this cause;

B. That the Court enter a decree adjudging Section 310(b)(1) of the Tax Equity and Fiscal Responsibility Act of 1982 as applied to the general obligations of South Carolina to be in violation of the Constitution of the United States;

C. That the Court enter a decree permanently enjoining and restraining the defendant

from enforcing or attempting to enforce Section 310(b)(1) of the Tax Equity and Fiscal Responsibility Act of 1982 against the general obligations of South Carolina; and

D. That the Court grant such other and further relief as it may deem proper and necessary.

T. TRAVIS MEDLOCK
Attorney General

C. TOLBERT GOOLSBY, JR.
Chief Deputy Attorney General

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ATTORNEYS for Plaintiff.

*Counsel of Record.

February 23, 1983

STATE OF SOUTH CAROLINA)
)
COUNTY OF RICHLAND)

VERIFICATION

PERSONALLY appeared before me, GRADY L. PATTERSON, JR., who, being duly sworn, deposes and says that he is the State Treasurer of South Carolina; that he has read the foregoing Complaint and knows the contents thereof; that the same are true of his own knowledge, except as to those matters and things stated therein upon information and belief, and that as to those matters and things, he believes them to be true.

GRADY L. PATTERSON, JR.
State Treasurer of South Carolina

SWORN to and subscribed
before me this 7th day
of February, 1983.

Sandra A. Lee (L.S.)
NOTARY PUBLIC FOR SOUTH CAROLINA

My Commission expires: 12/10/90

Section 310(b)(1) of the Tax Equity and Fiscal Responsibility Act of 1982 provides as follows:

> (b) OTHER OBLIGATIONS. --
>
> (1) OBLIGATIONS MUST BE IN REGISTERED FORM TO BE TAX-EXEMPT.-- Section 103 (relating to interest on certain governmental obligations) is amended by redesignating subsection (j) as subsection (k) and by inserting after subsection (i) the following new subsection:
>
> '(j) OBLIGATIONS MUST BE IN REGISTERED FORM TO BE TAX-EXEMPT.--
>
> '(1) IN GENERAL.-- Nothing in subsection (a) or in any other provision of law shall be construed to provide an exemption from Federal income tax for interest on any registration-required obligation unless the obligation is in registered form.
>
> '(2) REGISTRATION-REQUIRED OBLIGATION.-- The term "registration-required obligation" means any obligation other than an obligation which--
>
> '(A) is not of a type offered to the public,
>
> '(B) has a maturity (at issue) of not more than 1 year or
>
> '(C) is described in section 163(f)(2)(B).

'(3) SPECIAL RULES.--

'(A) BOOK ENTRIES PERMITTED.-- For purposes of paragraph (1), a book entry obligation shall be treated as in registered form if the right to the principal of, and stated interest on, such obligation may be transferred only through a book entry consistent with regulations prescribed by the Secretary.

'(B) NOMINEES.-- The secretary shall prescribe such regulations as may be necessary to carry out the purpose of paragraph (1) where there is a nominee or chain of nominees.' P.L. 97-248, 96 STAT. ____ (1982).

STATE OF SOUTH CAROLINA)
) AFFIDAVIT
COUNTY OF RICHLAND)

PERSONALLY appeared before me, Grady L. Patterson, Jr., who being duly sworn, stated:

1. That he is the duly elected, qualified and acting Treasurer of the State of South Carolina, an office created by the Constitution of South Carolina, and as such is responsible for and oversees the issuance of general obligation bonds by the State of South Carolina.

2. That South Carolina has issued general obligation bonds each year for several decades and plans to issue general obligation bonds subsequent to June 30, 1983. Approximately $247 million of unissued general obligation bonds have heretofore been authorized by the General Assembly of South Carolina. It is planned that these bonds will be issued over the next three years. Preparations must be made prior to issuing the bonds, including

compilation of an official statement, public advertisement, preparation of bid form, printing and official resolution of the State Budget and Control Board permitting the sale. These preliminary steps require a minimum of seven weeks with a greater amount of time normally allowed.

3. General obligation bonds evidence general obligation debt, which is debt secured in whole or in part by a pledge of the full faith, credit and taxing power of the State. The Constitution of South Carolina provides that general obligation debt may be incurred only for a public purpose.

4. Throughout its history South Carolina has found it essential to the integral operation of its government to borrow money. General obligation bonds are issued to provide and maintain essential governmental functions. For example, the proceeds from general obligation bonds have been and are planned to be used to construct prisons, schools, colleges,

highways, public buildings and port facilities. As of December 2, 1982, the principal amount of South Carolina general obligation bonds outstanding was $614.5 million.

5. According to the Daily Bond Buyer, in 1982 alone there was a total of $74.876 billion of municipal securities issued. Of that amount States issued a total of $19.3 billion according to the Public Securities Association of New York.

6. Without incurring long-term debt, South Carolina would not be able to provide the essential capital improvements nor fulfill its traditional role as provider of the prisons, schools, colleges, highways, public buildings and port facilities that are necessary to the functioning of the State and the welfare of its citizens.

7. The conditions and restrictions imposed upon South Carolina's borrowing power by the provisions of Section 310(b)(1) of Public Law 97-248, the Tax Equity and Fiscal

Responsibility Act of 1982 ("Section 310(b)(1)"), will materially interfere with and infringe upon the authority of South Carolina to borrow funds as illustrated by the examples appearing below.

8. If South Carolina were to evidence its borrowings by fully registered bonds, it would pay an estimated additional .25% interest on its borrowings. To illustrate, on November 9, 1982, South Carolina sold $115 million in State Capital Improvement General Obligation Bonds at public sale. The bonds, which mature over a period of fifteen years and two months, were offered as coupon bonds with the privilege of registration as to principal and as to both principal and interest. South Carolina received four bids, the lowest being that of a syndicate headed by Citibank, N.A., which produced an interest cost of 8.667%. The total interest to be paid by South Carolina over the life of the bonds will be Ninety-seven Million Two Hundred Forty-seven Thousand Six Hundred Sixty-eight and No/100 ($97,247,668.00) Dollars.

Had the bonds been offered as fully registered bonds, registrable as to both principal and interest, it is estimated that the interest cost would have been at least twenty-five (25) basis points higher or 8.92%. This would have added more than $2.8 million to the interest that South Carolina must pay. Of obvious significance is the fact that, despite the purchasers' being able to elect to receive fully registered bonds in whole or in part, no fully registered bonds were requested and the entire issue consisting of twenty-three thousand $5,000 pieces was delivered in coupon form without registration of any sort. Bond registrars and fees for transfer agents for bonds issued in registered form will add additional costs.

9. If South Carolina should decline to issue registered bonds and, instead, should continue to issue coupon bonds as has been its practice, Section 310(b)(1) would destroy the tax-exempt status of the interest to be paid by South Carolina to its lenders. The bond

market indicates that destruction of the tax-exempt status of the interest paid by South Carolina would force South Carolina to pay approximately 3% to 5% more by way of interest rates. In the example cited above this cost would be between $30 million and $50 million.

10. As manifested by the above example, Section 310(b)(1) materially infringes upon the essential operations of the government of South Carolina by restricting its authority to borrow money and by imposing an additional burden upon its borrowings.

FURTHER saith the deponent not.

GRADY L. PATTERSON, JR.

SWORN to and subscribed
before me this 7th day
of February, 1983.

Sandra A. Gee (L.S.)
NOTARY PUBLIC FOR SOUTH CAROLINA

My Commission Expires: 12/10/90

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IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1982

State of South Carolina,

Plaintiff,

vs.

Donald T. Regan, Secretary of the Treasury of the United States of America,

Defendant.

BRIEF IN SUPPORT OF MOTION TO FILE COMPLAINT

QUESTIONS PRESENTED

I. Do the provisions of Section 310 (b)(1) of the Tax Equity and Fiscal Responsibility Act of 1982, which require that debt obligations issued by the plaintiff must be in registered form in order that the interest paid thereon be exempt from federal income taxation, violate the United States Constitution and the Tenth Amendment thereto by abridging the plaintiff's power to borrow money?

II. Do the provisions of Section 310

(b)(1) of the Tax Equity and Fiscal Responsibility Act of 1982 violate the United States Constitution by subjecting the interest paid on the debt obligations issued by the plaintiff in bearer form to federal income taxation?

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JURISDICTION

The plaintiff State of South Carolina seeks to invoke the original jurisdiction of the Court pursuant to Article III, Section 2 of the United States Constitution which grants the Court original jurisdiction in an action between a State and a citizen of another State. The plaintiff State of South Carolina is a founding sovereign State of the United States and the defendant Donald T. Regan, who currently serves as the Secretary of the Treasury of the United States, is a resident and citizen of the State of Virginia.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Tenth Amendment to the United States Constitution provides:

> The powers not delegated to the United States by the Constitution, nor prohibited by it to the states, are reserved to the states respectively, or to the people. U.S.CONST. amend. X.

Section 310(b)(1) of the Tax Equity and Fiscal Responsibility Act of 1982 provides as follows:

> (b) OTHER OBLIGATIONS. --
>
> (1) OBLIGATIONS MUST BE IN REGISTERED FORM TO BE TAX-EXEMPT.-- Section 103 (relating to interest on certain governmental obligations) is amended by redesignating subsection (j) as subsection (k) and by inserting after subsection (i) the following new subsection:
>
> '(j) OBLIGATIONS MUST BE IN REGISTERED FORM TO BE TAX-EXEMPT.--
>
> '(1) IN GENERAL.-- Nothing in subsection (a) or in any other provision of law shall be construed to provide an exemption from Federal income tax for interest on any registration-required obligation unless the obligation is in registered form.
>
> '(2) REGISTRATION-REQUIRED OBLIGATION.-- The term "registration-required obligation" means any obligation other than an obligation which--
>
> '(A) is not of a type offered to the public,
>
> '(B) has a maturity (at issue) of not more than 1 year or
>
> '(C) is described in section 163(f)(2)(B).

'(3) SPECIAL RULES.--

'(A) BOOK ENTRIES PERMITTED.-- For purposes of paragraph (1), a book entry obligation shall be treated as in registered form if the right to the principal of, and stated interest on, such obligation may be transferred only through a book entry consistent with regulations prescribed by the Secretary.

'(B) NOMINEES.-- The secretary shall prescribe such regulations as may be necessary to carry out the purpose of paragraph (1) where there is a nominee or chain of nominees.' P.L. 97-248, 96 STAT. ____ (1982).

STATEMENT

On August 19, 1982, both houses of the United States Congress enacted Public Law 97-248, the "Tax Equity and Fiscal Responsibility Act of 1982" ("the Act"), and the President of the United States approved the Act on September 3, 1982. 1/ Section 310(b)(1) of the Act, which amends Section 103 of the Internal Revenue Code

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1/ U.S. CODE CONG. & AD. NEWS, No. 10 (December 1982), Cumulative Tables 98.

of 1954 [I.R.C. §§ 1 et seq.], provides that any debt obligation which is required by that Section to be issued in registered form loses its exemption from federal income taxation if it is not so issued. Expressly intended to be included as a registration-required obligation is "any obligation of a State or local government, ... [2/] Although the registration requirements as well as the alternative sanctions imposed by Section 310(b)(1) were originally scheduled to apply to any obligation issued after December 31, 1982, later Congressional action suspended the effective date until July 1, 1983. [3/] The administration and enforcement of the provisions of Section 310(b)(1) is to be performed by or under the supervision of the defendant Secretary of the Treasury pursuant to 26 U.S.C. § 7801.

[2/] S.Rep. 97-494, Vol. 2, 97th Cong., 2d Sess. 243, reprinted in U.S.CODE CONG. & AD. NEWS, No. 7 (September 1982), Legislative History 218.

[3/] Technical Corrections Act of 1982 § 306(b)(2), reported in PENSION & PROFIT-SHARING REPORT BULLETIN No. 16 (January 14, 1983) ¶ 233 at 41.

SUMMARY OF ARGUMENT

This action puts in issue the constitutionality of Section 310(b)(1) of the Act, which the plaintiff contends is an unconstitutional attempt by the United States Congress to restrict the manner in which South Carolina may exercise its power to borrow money for public purposes through the issuance of State bonds. The plaintiff's position is supported by decisions of the Court, beginning with Weston v. The City Council of Charleston, 27 U.S. (2 Pet.) 481 (1829), that recognize the constitutional limitation placed on the power of the federal and State governments to tax the obligations of one another and by National League of Cities v. Usery, 426 U.S. 833 (1976), in which the Court held that the Congress may not "displace the States' freedom to structure integral operations in areas of traditional governmental functions." National League of Cities at 845-46.

ARGUMENT

I. The complaint manifests a justiciable controversy over which the Court has and should assume original jurisdiction.

A. The plaintiff State of South Carolina is the real party in interest.

While the Court's original jurisdiction expressly includes "Controversies ... between a State and Citizens of another State," the State must in fact be the real party in interest.

> In determining whether the interest being litigated is an appropriate one for the exercise of our original jurisdiction, we of course look behind and beyond the legal form in which the claim of the State is pressed. Oklahoma ex rel. Johnson v. Cook [304 U.S. 387]. Arkansas v. Texas, 346 U.S. 368 at 371 (1953).

That the plaintiff is the real party in interest herein cannot be disputed for its bonds are the ones which under Section 310(b)(1) of the Act must be issued in registered form or lose their tax-exempt status. In

asking the Court to preserve its sovereign right to issue bonds in bearer form (and to effect the savings available thereby) [4/] without risking unconstitutional sanctions, South Carolina seeks to protect its own interests. One interest arises from its affirmative duty as a sovereign to provide services essential to its citizens' health and welfare which it accomplishes by, inter alia, borrowing money to provide those services. A second interest arises from its affirmative right as a co-equal sovereign with the United States to reciprocal immunity from taxation. South Carolina asserts these interests in its capacity as a sovereign State, i.e., under the United States Constitution and the Tenth Amendment thereto. Missouri v. Holland, 252 U.S. 416 (1920); National League of Cities, et al v. Usery, 426 U.S. 833 (1976)

[4/] See, Complaint, Aff. ¶ 9, supra at 17-18.

(n. 7 at 836). 5/

The plaintiff's standing to sue also arises from the fact that it will be substantially damaged in monetary terms by the enforcement of Section 310(b)(1). Although the tax on registration-required obligations issued in bearer form will be paid by the bondholders, South Carolina as the issuer will in effect absorb the cost of the tax either by paying a greater rate of interest on its obligations or by registering those obligations at an increased cost to itself. 6/ If it chooses to do neither, its obligations will not be as salable as potential purchasers turn instead to the more financially attractive obligations of those States

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5/ The Court's line of decisions holding that a State as parens patriae cannot sue to enjoin the enforcement of an allegedly unconstitutional act of Congress presents no obstacle to the assumption of original jurisdiction here because South Carolina does not assert a parens patriae interest. Cf., e.g., Massachusetts v. Mellon, 262 U.S. 447 (1923).

6/ See, Complaint, Aff. ¶ 8 and 9, supra at 16-18.

who do attempt to offset the effect of Section 310(b)(1).

B. The controversy is justiciable and is not barred by the sovereign immunity doctrine.

The case and controversy language of Article III, Section 2 of the United States Constitution, which has traditionally been interpreted to mean that courts are to restrict their adjudications to justiciable matters, necessarily applies to the exercise of the Court's original jurisdiction. Texas v. Florida, 306 U.S. 398 (1939).

South Carolina's Tenth Amendment claim seeks not an advisory opinion but instead the resolution of an immediate and concrete controversy. Section 310(b)(1) applies to all registration-required obligations issued after June 30, 1983, and, as its Treasurer states, South Carolina fully intends to issue general obligation bonds after June 30, 1983. 7/ The

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7/ See, Complaint, Aff. ¶ 2, supra at 13.

mechanics of the issuance must begin well before that date, however, and the validity vel non of Section 310(b)(1) will determine in large part the amount of those bonds, their interest rate and their marketability. If South Carolina can know whether or not the provisions of Section 310(b)(1) are enforceable against its general obligations, it will be in an infinitely better position to make its fiscal decisions; for example, if Section 310(b)(1) cannot constitutionally be enforced against its obligations, then South Carolina will be able to issue those obligations at a substantial savings. 8/ But if Section 310(b)(1) is enforceable, then South Carolina must allow for the added costs of the issuance by, inter alia, adjusting its general appropriations in other areas. Regardless of the Court's decision on the merits, the impact of that decision will be certain and

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8/ Id., ¶¶ 8 and 9, supra at 16-18.

significant. Again, South Carolina asserts that the controversy is real. 9/

Moreover, South Carolina's Tenth Amendment claim is not barred by the doctrine of sovereign immunity. The Court long ago declared that a suit to enjoin a federal officer from enforcing an allegedly unconstitutional statute does not constitute a suit against the sovereign, reasoning that "the conduct against which specific relief is sought is beyond the officer's power and is, therefore, not the conduct of the sovereign." Larson v. Domestic and Foreign Commerce Corp, 337 U.S. 682 at 690 (1949). See also, Oregon v. Mitchell, 400 U.S. 112 (1970); South Carolina v. Katzenbach, 383 U.S. 301 (1966); Land v. Dollar, 330 U.S. 731 (1947); Missouri v. Holland, 252 U.S. 416 (1920).

Finally, the Court has recognized that

9/ Nor does South Carolina's claim involve a nonjusticiable political question. See, e.g., Marbury v. Madison, 5 U.S. (1 Cranch) 60 (1803).

a bill in equity for injunctive and declarative relief is proper in this type of action. In Missouri v. Holland, supra, the Court upheld Missouri's right to bring a bill in equity to enjoin a federal official from enforcing allegedly unconstitutional regulations promulgated under the Migratory Bird Treaty Act. Although Missouri's Tenth Amendment claim was rejected, the Court declared that a bill in equity "is a reasonable and proper means to assert the alleged quasi-sovereign rights of a State." 252 U.S. at 431. See also, Colorado v. Toll, 268 U.S. 228 (1925).

C. The Court should assume original jurisdiction herein.

While the plaintiff recognizes that the language of Article III, Section 2 does not make the Court's original jurisdiction exclusive, Congress has effectively foreclosed

any lower court challenge herein. [10] There is therefore a compelling reason for the Court to assume original jurisdiction for otherwise the plaintiff will be without an available forum, adequate or otherwise, within which to assert its claim. Cf., Illinois v. City of Milwaukee, 406 U.S. 91 (1972).

The importance of promptly securing a definitive resolution to the fundamental constitutional issue is another compelling reason for the Court to hear this action originally. Because of the significant adverse

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[10] The usual bases of judicial review of tax matters are available only to taxpayers. E.g., I.R.C. § 7422. Under the Anti-Injunction Act [26 U.S.C. § 7421(a)], no action may be maintained seeking to enjoin the levy or collection of federal taxes. This provision has been broadly construed and would no doubt emcompass the present situation. Cf., Bob Jones University v. Simon, 416 U.S. 725 (1974). Similarly, the Federal Declaratory Judgment Act [28 U.S.C. § 2201] expressly forbids declaratory judgments concerning tax matters and is generally held to be "at least as broad" as the Anti-Injunction Act. Alexander v. Americans United, Inc., 416 U.S. 752 at 759, n. 10 (1974).

impact which the provisions of Section 310(b)(1) will immediately have on the plaintiff's exercise of its governmental functions, it has a vital interest in having the question of the validity of Section 310(b)(1) resolved as expeditiously as possible. As hereinabove noted, South Carolina must make preparations to comply with Section 310(b)(1) if it is enforceable and those preparations involve outlays of money. If Section 310(b)(1) is not enforceable and these preparations need not have been made, South Carolina will have wasted that money. On the other hand, if Section 310(b)(1) is enforceable and South Carolina has not prepared to comply with its requirements, the marketability of its general obligation bonds will be seriously jeopardized. South Carolina cannot withstand without severe hardship the potential loss of money under either alternative. The fact that all fifty States will also be immediately economically burdened to a significant extent by the provisions of Section

310(b)(1) compounds the urgency of a definitive resolution. 11/

Moreover, the plaintiff's claim presents the precise issues on which the Court has declared its intent to concentrate the exercise of its original jurisdiction. In declining to assume original jurisdiction over a suit between a State and a citizen of another State which raised "no serious issues of federal law," the Court declared:

> ... This Court's paramount responsibilities to the national system lie almost without exception in the domain of federal law. As the impact on the social structure of federal common, statutory, and

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11/ The requirements of Section 310(b)(1) apply to the issuance of obligations by all fifty States. The plaintiff alleges that it alone will be burdened by an extra $2.8 million on a single moderate sized sale of capital improvement general obligations. See, Complaint, Aff. ¶ 8, supra at 16-17. Even more staggering is the economic effect which Section 310(b)(1) will immediately have throughout the United States based on the total amount of general obligation bonds issued by other States in 1982 ($19.3 billion) and the total amount of municipal paper issued throughout the United States in 1982 ($74 billion). Id., ¶ 5, supra at 15.

> constitutional law has expanded, our attention has necessarily been drawn more and more to such matters.... Ohio v. Wyandotte Chemicals Corp., 401 U.S. 493 at 498 (1971).

Nothing involves serious issues of federal law more acutely than the proper relationship between the governments of the States and the United States in the federal system intended by the founding fathers. [12/] The Court is uniquely empowered to preserve the federal system by, inter alia, declaring and maintaining the provisions of the United States Constitution. Whether or not South Carolina can continue to function in its traditional role as a sovereign untrammeled by acts of the United States Congress raises a basic federal law issue, one which only the Court is able to resolve. See, e.g., Oregon v. Mitchell, 400 U.S. 112 (1971); South Carolina v. Katzenbach, 383 U.S. 301 (1966).

12/ The merits of the plaintiff's claim are argued more fully under Question II and Question III, infra.

Additionally, although the controversy is a crucial one and the issue is of great moment, the legal question is not complex. The dispute requires no discovery nor the taking of extensive testimony so that the Court will not become involved in the role of fact finder for which, it has stated, it is "ill-equipped." Ohio v. Wyandotte Chemical Corp., supra at 498.

In summary, this action is an appropriate one for the Court to exercise its original jurisdiction: the plaintiff is the proper party to raise the issues herein because Section 310(b)(1) injures it both monetarily and in its capacity as a sovereign State; the economic effect of the provisions of Section 310 (b)(1) is immediately substantial and far-reaching; and the issues raise serious and important concerns of federalism "fully in accord with the purposes and reach of [the Court's] original jurisdiction." Maryland v. Louisiana, 451 U.S. 725 at 744 (1981).

II. Section 310(b)(1) of the Act violates the United States Constitution and the Tenth Amendment thereto by abridging the plaintiff's power to borrow money.

South Carolina as a sovereign State possesses a long-recognized implied constitutional power to borrow money for public purposes. In Pollock v. Farmers' Loan & Trust Company, 157 U.S. 429 (1895), the Court declared:

> ... under the fundamental law, as to the power to borrow money, neither the United States on the one hand, nor the states on the other, can interfere with that power as possessed by each and an essential element of the sovereignty of each. 157 U.S. at 585.

The plaintiff's power to borrow money free from federal regulation arises, then, from its status as a sovereign power, which status is inherent in the federal system intended by the United States Constitution. See generally, Pollock v. Farmers' Loan & Trust Company,

supra; Lane County v. Oregon, 74 U.S. (7 Wall.) 101 at 104 (1869).

The borrowing power also expressly arises under the Tenth Amendment to the United States Constitution as a power "reserved to the States." In National League of Cities v. Usery, 426 U.S. 833 (1976), the landmark case on the Tenth Amendment, the Court considered the applicability of the minimum wage provisions of the Fair Labor Standards Act to the States and their political subdivisions. The cities and States challenged the United States Congress' authority to legislate minimum wage standards applicable to public sector employees, not as beyond its Commerce Clause power, but instead as prohibited by the Tenth Amendment, which imposes an affirmative limitation on that power. The Court overruled a previous decision and distinguished another, holding that "insofar as the challenged amendments operate to directly displace the States' freedom to structure integral operations in

areas of traditional governmental functions, they are not within the authority granted Congress...." 426 U.S. at 852. The decision overruled was Maryland v. Wirtz, 392 U.S. 183 (1973), which had upheld the extension of the Fair Labor Standards Act to State-operated schools and hospitals. Relying on Maryland v. Wirtz, the Court had later found that the Economic Stabilization Act, which provided for a wage freeze, could be properly applied to the States. Fry v. United States, 421 U.S. 542 (1975). The Court in National League of Cities declined to overrule Fry, even though it was based on Maryland v. Wirtz, but distinguished it in three particulars from National League.

First, Fry involved legislation which was aimed at an emergency situation and which was carefully limited in scope and time. In addition, the effect of the wage freeze was not to displace State choices but to require that the choices already in effect be maintained during the emergency. Finally, the Court in

National League of Cities noted that the statute in Fry actually reduced the pressures on State budgets rather than increased them. 426 U.S. at 853.

Like the legislation in National League of Cities, Section 310(b)(1) at issue here is distinguishable from the legislation in Fry. Just as the attempt to legislate wage provisions in National League of Cities impermissibly withdrew from the States the authority to make fundamental decisions, Section 310(b)(1) seeks to so economically restrict the alternatives available to South Carolina in the exercise of its power to borrow money that it has withdrawn from South Carolina any real freedom to issue obligations in the manner it deems most suitable to effect its responsibility to perform essential functions.

Since its decision in National League of Cities, the Court has clarified its position as to what requirements must be satisfied before a Tenth Amendment claim seeking to

invalidate Commerce Clause legislation can succeed. In Hodel v. Virginia Surface Mining & Reclamation Association, 452 U.S. 264 (1981), the Court interpreted National League of Cities to require:

> First, there must be a showing that the challenged statute regulates the 'States as States.' Second, the federal regulation must address matters that are indisputably 'attribute[s] of state sovereignty.' And, third, it must be apparent that the States' compliance with the federal law would directly impair their ability 'to structure integral operations in areas of traditional functions' [citations omitted]. 452 U.S. at 287-288.

The legislation at issue in Hodel was the Surface Mining Act which, in part, prescribed minimum performance standards that had to be met by individuals mining on certain types of land. The plaintiffs claimed that the States traditionally regulated land use and any attempt by the Congress to prescribe minimum standards violated the Tenth Amendment. The

plaintiffs' claim was unsuccessful because it failed to satisfy the first of the three requirements, i.e., that the challenged legislation regulated the States as States. The Court reasoned that the Surface Mining Act governed only the activities of private persons, that the States were not compelled to enforce the Act and that no State funds had to be expended because of the Act. 452 U.S. at 288.

The tax imposed by Section 310(b)(1) of the Act concededly falls initially on the holder of State general obligation bonds rather than on the State as issuer. Unlike the Mining Act provisions in Hodel, however, the effect of Section 310(b)(1) on State activities is not incidental. Under the Mining Act, the States were free to legislate their own programs within certain guidelines or to refrain from acting at all in which event the full regulatory burden would be borne by the federal government and imposed on individual

and corporate miners. It cannot be argued that under Section 310(b)(1) an issuing State is equally free to do nothing and that the burden will then fall only on the individual holder of its bonds. The Court has repeatedly recognized that a tax on the interest from government bonds burdens the issuer. See, Pollock v. Farmers Loan & Trust Company, supra; Weston v. City Council of Charleston, 27 U.S. (2 Pet.) 481 (1829).

The second requirement of the National League of Cities standard is that the challenged legislation must address matters that are indisputably attributes of State sovereignty, that is, the interest advanced by the State must involve "functions essential to separate and independent existence." 426 U.S. at 850. There can be no doubt that South Carolina's power to borrow money is a function essential to its separate and independent existence. Few "attributes of sovereignty" insure the independence

of a State more certainly than the power to raise money to remain financially secure. Every public service provided by South Carolina and its subdivisions is affected when its power to borrow money is interfered with. As in National League of Cities, where the Court noted that the legislation at issue withdrew from the States the authority to make those fundamental employment decisions upon which their systems for the performance of their essential functions rested [426 U.S. at 851], the power to borrow money is likewise an attribute of sovereignty upon which South Carolina's entire system for the performance of its integral State functions rests.

The third and final requirement of National League of Cities is that compliance with the legislation will seriously impair the State's ability to structure its integral operations. This third requirement was fatal to the Tenth Amendment claim of State railroad employees in United Transportation Union v. Long Island Railroad Company, 455 U.S. ____,

102 S.Ct. 1349 (1982). The Court in United Transportation found that the operation of a railroad by the State was not an integral part of its government activity but was a function traditionally performed by private industry. Federal regulation of such railroads under the Commerce Clause was held not to impair a State's ability to function as a State. 102 S.Ct. at 1354. It cannot be seriously contended that the borrowing of money is a "function previously performed by the private sector" such that application of the Tenth Amendment would allow the State's assumption of this function to erode the federal government's authority to regulate in an area traditionally allowed it. As discussed earlier, nothing is so fundamental to the States' ability to perform their essential functions than the ability to raise money to support their operations. Because it seriously interferes with South Carolina's power to raise money, Section 310(b)(1) impermissibly impairs South

Carolina's ability "to fulfill its role in the Union." 102 S.Ct. at 1356.

One final consideration in analyzing National League of Cities is the Court's declaration that in some cases the nature of the federal interest advanced may require State submission even though all of the above discussed requirements are met. Hodel, 452 U.S. at 288, n. 29. This "overriding interest" factor has been characterized as an exception to National League of Cities [13/] and, although the Court has considered no cases involving this exception since it was first enunciated, the emergency situation in Fry was cited as an example of circumstances that would justify requiring a State to submit to federal encroachment on its sovereignty. Id. The plaintiff would urge the Court to refrain from engaging in

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13/ See, Federal Energy Regulatory Commission v. Mississippi, ____ U.S. ____, 102 S.Ct. 2126 at 2147, n. 4 (1982) (Justice O'Connor, concurring in part and dissenting in part).

the balancing action suggested in the footnote in Hodel except where the essential nature of the State function being overridden is in doubt. There can be no such doubt with respect to South Carolina's power to borrow money, long recognized by the Court as essential to its sovereignty as a State. Moreover, there is no overriding federal interest advanced by the enactment of Section 310(b)(1) which would even remotely justify the resulting blow to South Carolina's sovereignty.

Having made this assertion, South Carolina is not unmindful of the reasons asserted by the Senate Finance Committee for the change sought to be effected by Section 310(b)(1). [14/] However justified they may be and however salutary the result intended to be

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[14/] S.REP. 97-494, Vol. 2, 97th Cong. 2d Sess. 242, reprinted in U.S. CODE CONG. & AD. NEWS, No. 7 (September 1982) 217. The Senate Finance Committee's action, however, was not unanimous. Id., Minority Views of Senators Long, Bentsen, Matsunaga, Moynihan, Boren and Mitchell 376-377.

reached by the enactment of Section 310(b)(1), the invasion of South Carolina's sovereign right and power is a far greater evil than that sought to be cured. If the United States Congress can require that South Carolina's obligations must be issued in registered form in order to keep intact its immunity from federal income taxation, then federal legislation similarly limiting the time of issuance, amount, maturity date, interest rate, market and purpose of those obligations would also be possible. In other words, the Congress could provide that in the year 1983 South Carolina can issue only $5 million of its general obligation bonds which must be sold only in July, 1983, must mature in 1988, must bear 5 per cent interest, must be expended for highway purposes only and must be sold only to citizens of South Carolina. If unhalted by the Court, the Congress could thus reduce South Carolina's once-called sovereign power to borrow money to a matter of congressional grace or whim.

In his dissent in Elrod v. Burns,

427 U.S. 347 (1976), Chief Justice Burger characterized National League of Cities as follows:

> Only last ... we took steps to arrest the downgrading of States to a role comparable to the departments of France, governed entirely out of the national capital. Constant inroads on the powers of the States to manage their own affairs cannot fail to complicate our system and centralize more power in Washington. 427 U.S. at 375-376.

The exigencies of economic change have whittled away some of the limitations that were formerly thought to exist, principally through the judicial expansion of "general welfare" powers. Each time such action occurs, the federal system is undermined. As Justice Powell observed in his dissent in Federal Energy Regulatory Commission, supra, quoting a constitutional law professor on the danger of such gradual encroachment by the federal sovereign:

> 'Of course, no one expects Congress to obliterate the states, at least in one fell

> swoop. If there is any danger, it lies in the tyranny of small decisions--in the prospect that Congress will nibble away at state sovereignty, bit by bit, until someday essentially nothing is left but a gutted shell.' 102 S.Ct. at 21 (quoting L. Tribe, American Constitutional Law 302 (1978)).

The United States Constitution was written with the express guarantee, i.e., the Tenth Amendment, that the States are to retain all the attributes of sovereignty in certain areas. The power to borrow money is without question one power that is "reserved to the States." However arguably inconsiderable the effect may be, Section 310(b)(1) represents an attempt by the United States Congress to retard the ability of South Carolina to function as a sovereign in an area reserved to it by the United States Constitution and, to that extent, violates the United States Constitution and in particular the Tenth Amendment thereto.

III. Section 310(b)(1) of the Act violates the United States Constitution by subjecting the interest paid on the debt obligations issued by the plaintiff in bearer form to federal income taxation.

In providing that the interest paid on State obligations which are not in registered form is not exempt from federal income taxation, Section 310(b)(1) of the Act goes beyond the power of the United States Congress -- the interest on such obligations is protected from taxation by the United States Constitution.

Furthermore, this protection from taxation exists irrespective of the power of the Congress to impose registration requirements. "[I]t is one thing ... to decide that a state which chooses to engage in activities which Congress has a right to control must do so on Congress' terms ... but it is quite another to extract from a state a most fundamental aspect of its sovereignty." Maryland v. EPA, 530 F.2d 215 at 225-226 (4th Cir. 1977),

vacated and remanded sub.nom. EPA v. Brown, 431 U.S. 99 (1977); District of Columbia v. Train, 521 F.2d 971 at 990-994 (D.C. Cir. 1975), vacated and remanded sub.nom. EPA v. Brown, 431 U.S. 99 (1977); Brown v. EPA, 521 F.2d 827 at 837-842 (9th Cir. 1975), vacated and remanded, 431 U.S. 99 (1977).

That interest on State obligations may not be taxed by the federal government has long been established. In Weston v. The City Council of Charleston, 27 U.S. (2 Pet.) 481 (1829), Chief Justice Marshall, speaking for a majority of the Court, held that the ordinance of the City of Charleston imposing a tax of "twenty-five cents upon every hundred dollars of ... six and seven per cent stock of the United States" was unconstitutional. Counsel for the taxpayer argued:

> The contract of the general government is invaded, and its credit impaired. Its competency to negotiate loans may be destroyed by the admission of this power of taxation. There are two sources of revenue which are essentially the right of the general government -- that of imposing duties, and that of borrowing money on the credit of the

> nation. The safety of the whole depends upon the free and undisturbed exercise of these powers. 27 U.S. (2 Pet.) at 482.

Chief Justice Marshall agreed:

> If the right to impose the tax exists, it is a right which in its nature acknowledges no limits. It may be carried to any extent within the jurisdiction of the State or corporation which imposes it, which the will of each State and corporation may prescribe. 27 U.S. (2 Pet.) at 487.

In Pollock v. Farmers' Loan & Trust Company, 157 U.S. 429 (1895), the Court considered, among other questions, whether the income from State-issued securities could be taxed to the holder under the Revenue Act of 1894. Recognizing that previous case law forbade federal taxation of the property or revenues of a State, Chief Justice Fuller concluded:

> But we think the same want of power to tax the property or revenues from the states or

> their instrumentalities exists in relation to a tax on the income from their securities, and for the same reason, and that reason is given by Chief Justice Marshall in Weston v. Charleston, ..., where he said: 'The right to tax the contract to any extent, when made, must operate on the power to borrow before it is exercised, and have a sensible influence on the contract. The extent of this influence depends on the will of a distinct government. To any extent, however inconsiderable, it is a burden on the operations of government. It may be carried to an extent which shall arrest them entirely. * * * The tax on government stock is thought by this court to be a tax on the contract, a tax on the power to borrow money on the credit of the United States, and consequently to be repugnant to the Constitution.' Applying this language to these municipal securities, it is obvious that taxation on the interest therefrom would operate on the power to borrow before it is exercised, and would have a sensible influence on the contract, and that the tax in question is a tax on the power of the states and their instrumentalities to borrow money, and consequently repugnant to the Constitution. 157 U.S. at 585.

This doctrine of intergovernmental immunity had its genesis in Chief Justice

Marshall's decision in McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819). Weston v. City Council, supra, applied the doctrine to taxes levied by the State upon securities of the federal government and the Pollock decision recognized that the converse was true by extending that immunity to the interest paid on State and municipal bonds. 15/

The ultimate result of Pollock was to invalidate the Revenue Act of 1894 because it unconstitutionally failed to apportion the income tax among the several States. In response to this result, the Congress passed the Sixteenth Amendment to the United States Constitution in 1913. But the debate in the

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15/ After the decision was rendered, Pollock was reargued and new opinions were filed at 158 U.S. 602 (1895). The rehearing allowed the Court to "broaden the field of inquiry" and to determine to which of the two classes of taxes, direct or indirect, the income from rents of real estate and from bonds belonged. The holding that taxation of the receipts from municipal bonds is a tax on the power to borrow money and, consequently, repugnant to the United States Constitution remained unchanged. 158 U.S. at 618.

United States Senate makes it clear that the Sixteenth Amendment was not intended to give to the Congress the power to tax the income from State obligations. It was conceded that such a power would destroy the federal system. See, 45 CONG. REC. 1696 (1910).

Just two years after the adoption of the Sixteenth Amendment, in Brushaber v. Union Pacific Railroad, 240 U.S. 1 (1916), the claim was made that the effect of the Sixteenth Amendment was to extend the class of subjects which could be constitutionally taxed by the Congress because of the inclusion of the phrase "incomes, from whatever source derived." After reviewing the history of the Sixteenth Amendment and its relation to the Pollock decision, the Court reached the conclusion that the Sixteenth Amendment did not expand the federal taxing power to new subjects.

> It is clear on the face of [the Amendment] that it does not purport to confer power to levy income taxes in a general sense, -- an authority already possessed

> and never questioned, -- or to limit and distinguish between one kind of income taxes and another, but that the whole purpose of the Amendment was to relieve all income taxes when imposed from apportionment from a consideration of the source whence the income was derived. 240 U.S. at 17-18.

This pronouncement of the law has rested without serious challenge from 1916 to 1982. From the date of the adoption of the Sixteenth Amendment to the present the Congress has made no effort to tax the interest paid by the States to the holders of their bonds. The provisions of Section 103 of the Internal Revenue Code do not create the tax exemption that applies to the interest paid by the States upon their bonds; instead, they are necessarily purely declarative of the existing state of the law.

Through oblique means the Congress is now seeking to avoid the decisions of this Court and thus to amend the United States Constitution by legislative fiat. South Carolina

urges the Court to let stand the long accepted interpretation of the Constitution itself, to continue to recognize the federal system and to continue to uphold the essential corollary that State governmental action is free from congressional interference except as otherwise provided in the Constitution itself. The provisions of Section 310(b)(1) which conditionally tax the interest paid on State obligations are patently unconstitutional and South Carolina cannot without doing violence to the United States Constitution be forced to accept those provisions as an unconstitutional alternative.

CONCLUSION

This legislation is constitutionally infirm for two reasons. It asserts congressional controls in a field preserved to the States, thus impermissibly intruding on the sovereignty of the States, and, in blind-side fashion, it unconstitutionally asserts the right of the federal government to tax the

interest paid by States on their debt obligations despite clear and sound precedent to the contrary.

The constitutional powers of the States must not be carelessly abrogated. The continued existence of the federal system secures the liberties of the citizens of the United States as no other form of government could and far outweighs any remote administrative convenience attaching to the plan here promoted by the United States Congress. That plan must be judicially voided.

Respectfully submitted,

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February 7th, 1983

CERTIFICATE OF SERVICE

I, KAREN LeCRAFT HENDERSON, counsel of record for the plaintiff and a member of the Bar of the Court, do hereby certify that, in accordance with Rule 28.4(a), three (3) copies of the Motion for Leave to File Complaint, Complaint and Supporting Brief were served on all parties required to be served on this date by depositing same in the United States mail, first-class postage prepaid, and addressed as follows: The Solicitor General of the United States, Department of Justice, Washington, D.C. 20530 and The Honorable Donald T. Regan, Secretary of the United States Treasury, Department of the Treasury, 1500 Pennsylvania Avenue, N.W., Washington, D.C. 20220.

This 7th day of February, 1983.

Karen LeCraft Henderson
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FILED
MAY 10 1985
ALEXANDER L. STEVAS,
CLERK

No. 94, Original

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1982

State of South Carolina,

Plaintiff,

vs.

Donald T. Regan, Secretary of the Treasury of the United States of America,

Defendant.

MOTION FOR PRELIMINARY INJUNCTION, AFFIDAVITS AND MEMORANDUM IN SUPPORT OF MOTION

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Donald T. Regan, Secretary of the Treasury of the United States of America,

Defendant.

MOTION FOR PRELIMINARY INJUNCTION

To The Honorable Warren E. Burger, Chief Justice and Justice for the District of Columbia Circuit:

Now comes the plaintiff in the above entitled action and respectfully moves the Court and the Chief Justice to whom this motion is presented that a preliminary injunction be issued directed to the defendant Donald T. Regan, Secretary of the Treasury of the United States of America, and his officers, agents and employees, restraining them from enforcing the provisions of Section 310(b)(1) of Public Law 97-248, the "Tax Equity and Fiscal Responsibility Act of 1982" (the "Act"), scheduled to go into effect on July 1, 1983, until the plaintiff's motion now on file with the Court for leave to file a complaint against the defendant Donald T. Regan, Secretary of the United States Treasury, has been passed upon by the Court and the matters set forth in the complaint determined. In the alternative, the plaintiff prays for such additional decree or order as may be just and proper to preserve the status quo of the right of the State of South Carolina to borrow money for public purposes through the issuance of State bonds in coupon form unimpaired by the provisions of Section 310(b)(1) of the Act.

This motion is based upon the verified complaint

attached to the Motion for Leave to File Complaint and the affidavit attached thereto as well as the affidavits of the Honorable Grady L. Patterson, Jr., Treasurer of the State of South Carolina, the Honorable Harlan E. Boyles, Treasurer of the State of North Carolina, the Honorable Louis L. Goldstein, Comptroller of the State of Maryland, the Honorable William S. James, Treasurer of the State of Maryland, the Honorable William M. Nixon, Auditor of the State of Georgia, the Honorable Anthony J. Solomon, Treasurer of the State of Rhode Island, the Honorable Richard W. Flanders, Treasurer of the State of New Hampshire, and C. W. Houser, all of which affidavits are attached hereto. It is requested pending the ruling of the Court on the Motion for Leave to File Complaint and, should such motion be granted, until such time as the controversy set forth in the complaint is decided and the rights of the parties adjudicated.

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No. 94, Original

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SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1982

State of South Carolina,

Plaintiff,

vs.

Donald T. Regan, Secretary of the Treasury of the United States of America,

Defendant.

AFFIDAVIT OF GRADY L. PATTERSON, JR.

State of South Carolina)
)
County of Richland)

Personally appeared before me, Grady L. Patterson, Jr., who being duly sworn, states:

1. He is the duly elected, qualified and acting Treasurer of the State of South Carolina and as such is responsible for and oversees the issuance of general obligation bonds by the State of South Carolina.

2. He is familiar with the facts in the above-entitled suit and this affidavit is made in support of the plaintiff's motion for the issuance of a preliminary injunction in conjunction with the prayer contained in the complaint heretofore filed herein.

3. The State of South Carolina plans to issue approximately $70 million of general obligation bonds during late July or August, 1983, that is, after July 1, 1983, the effective date of the provisions of Section 310(b)(1) of Public Law 97-248, the Tax Equity and Fiscal Responsibility Act of 1982 ("the Act"), which provisions

require that State obligations must be issued in fully registered form in order that the interest paid thereon by the State to its lenders remain exempt from federal income taxation.

4. The proposed $70 million issue includes State capital improvement obligations incurred in order to finance inter alia penitentiary facilities, facilities for State institutions of higher learning and hospital facilities for the teaching hospital of the Medical University of South Carolina.

5. In order to comply with the registration requirement of Section 310(b)(1) of the Act, the State of South Carolina will have to incur additional initial costs, including registrar's fees, which will be substantially above the costs of issuance if those bonds were issued in coupon form.

6. Owing to the registration requirement of the Act, these additional costs for the proposed $70 million issue are estimated at not less than $100,000 with annual recurring costs estimated at not less than $25,000 for each of the 15 years that the bonds are outstanding; the deponent affirms the statement in his affidavit attached to the complaint that the interest rate will be 25 basis points higher than if the bonds were issued in coupon form, resulting in a burden of approximately $168,000 in additional interest payments during the life of the bonds.

7. Even more significant than the increased costs resulting from compliance with the registration requirement of Section 310(b)(1) of the Act is the fact that this requirement will immediately harm the sovereignty of the State of South Carolina by abridging its inherent sovereign power to borrow money and by violating the constitutional principle of federalism, which is the foundation upon which

the nation rests and which results in the doctrine that neither sovereign may tax the other.

8. Irrespective of the final decision of the United States Supreme Court in this cause, any violation of South Carolina's sovereignty for any period of time imposes an intolerable burden upon the federal system and thus causes irreparable harm to South Carolina, to her sister States and to the national government.

9. Unless preliminarily enjoined by the Court, the defendant Donald T. Regan, Secretary of the United States Treasury, will, upon information and belief, beginning July 1, 1983, enforce and implement the registration requirement imposed by Section 310(b)(1) of the Act.

FURTHER saith the deponent not.

Grady L. Patterson

GRADY L. PATTERSON, JR.

SWORN to and subscribed
before me this 6th day
of May, 1983.

Sandra A. Lee (L.S.)
NOTARY PUBLIC OF SOUTH CAROLINA
My Commission Expires 12/10/90

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1982

State of South Carolina,
Plaintiff

vs.

Donald T. Regan, Secretary of the Treasury of the United States of America,
Defendant

AFFIDAVIT IN SUPPORT OF SOUTH CAROLINA

State of North Carolina

County of Wake

AFFIDAVIT

I, Harlan E. Boyles, Treasurer of the State of North Carolina, and Chairman of the North Carolina Local Government Commission, do hereby state that the implementation of the provisions of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) will have a substantial negative impact upon the State and its political subdivisions in that:

- North Carolina and its political subdivisions have traditionally issued bearer obligations and the "market" for our debt has been in this type of obligation. Therefore, some premium will be required to attract investors to make the change to unfamiliar "registered" obligations. This is particularly true in light of the fact that traditional bearer obligations will be available in the secondary market for some time to come.

- Extensive changes are being made in our statutes, regulations and procedures in order to attempt to comply with the requirements of a fully registered system. Unfamiliarity with the changes will cause operational inefficiencies for at least a shakedown period. With the vast number of changes and the importance of them to purchasers, as well as issuers, there is cost inefficiency in the short time frame for implementation. An inartfully drawn statute, regulation or procedure can have disasterous results. Fear of such a happenstance will cost us considerably in the marketplace.
- Professional transfer agents will in most cases be required for the State and its political subdivisions to meet the requirements of the "registered" municipal marketplace. The costs of these services are unknown at this time even by the potential providers. Clearly, the costs for the new services provided will make issuing "registered" obligations a more expensive proposition. Also, it appears it will be necessary to appropriate annually an amount to handle these transfer agency costs. With the uncertain level of these costs, the State and the various units of government in our State will face difficult problems in accurately forecasting the "true" cost of their debt obligations.
- Until systems of transfer for these "registered" obligations have been fully implemented, there may be delays in transferring ownership and crediting interest payments. Any such problems could drive investors from the municipal market with a concurrent increase in borrowing costs for units of government.

For the reasons above stated, I believe that implementation of TEFRA prior to a determination of its applicability to State and local debt issuances would be unjust in that borrowing costs will be substantially increased and certain marketing structures and practices will be modified with possible long-term negative impacts on the State of North Carolina and its political subdivisions. It is for these reasons that I believe the implementation of TEFRA must be stayed pending a final decision on the legality of this legislation.

Dated this the 29th day of April, 1983.

Harlan E. Boyles
State Treasurer

Subscribed and sworn to before me this

29th day of April, 1983.

Notary Public

Faye N. Smith

My Commission Expires 11/3/87

No. 94, Original

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1982

State of South Carolina,

Plaintiff,

vs.

Donald T. Regan, Secretary of the Treasury of the United States of America,

Defendant.

AFFIDAVIT OF LOUIS L. GOLDSTEIN,
COMPTROLLER OF THE STATE OF MARYLAND

State of Maryland
Anne Arundel County

Personally appeared before me, Louis L. Goldstein, who being duly sworn, states:

1. That he is the duly elected, qualified and acting Comptroller of the State of Maryland, whose duties include general superintendence of the fiscal affairs of the State and service, along with the Governor and State Treasurer, on the Board of Public Works, the body that issues the general obligation debt of the State.

2. That Maryland has joined with the State of Texas, and other states, as Amicus Curiae in this action.

3. That the State of Maryland plans to issue approximately $220 million of general obligation bonds within the 12 month period after July 1, 1983, the effective date of the provisions of Section 310(b)(1) of Public Law 97-248, the Tax Equity and Fiscal Responsibility Act of 1982 ("the Act"), which provisions require that State obligations must be issued in fully registered form in order that the interest paid thereon by the State to its lenders remain exempt from federal income taxation.

4. That the proposed $220 million of issues include obligations incurred in order to finance such necessary and vital public projects as schools, colleges, roads, prisons and other general capital construction projects.

5. That in order to comply with the registration requirement of Section 310(b)(1) of the Act, the State of Maryland will have to incur additional initial costs, including registrar's fees, which will be substantially above the costs of issuance if those bonds were issued in coupon form.

6. That while the exact amount of increased cost is unknown at present, because bids will not be received from potential providers of such registration service until approximately three (3) weeks from this date, estimates have been prepared by the employees of State government responsible for same.

7. That, owing to the registration requirement of the Act, these additional costs during the year of issuance for the proposed issues of approximately $220 million will exceed $368,000; if, however, the issue(s) were in coupon form, the same cost would be drastically reduced to approximately $148,000.

8. That it is expected that the State's earnings on the money set aside to pay the interest on said bonds according to the terms of the issues will be reduced, through changes in methods of payment caused by registration, from approximately $600,000 earned during the fiscal year ending June 30, 1982, to $50,000 a year or less for each year such registered issues are outstanding.

9. That these enormous additional initial costs incurred due to the registration requirement of the Act will result in immediate harm to the State of Maryland in that it will be required to reduce other state general fund expenditures in order to pay such costs.

10. That, additionally, in complying with the registration requirement of the Act, the State of Maryland will have to pay increased costs, which costs will continue through the life of the issue, in registrar's and transfer agent's fees; that, with respect to the proposed issues totaling $220 million, these increased costs will be approximately $64,000 annually, with such costs increasing over the life of the issue.

11. That but for the registration requirement of the Act, Maryland would issue the proposed bonds in coupon form, at an interest rate estimated to be 50 basis points lower than the rate Maryland must pay its lenders on the same bonds in registered form.

12. That even more significant than the increased costs resulting from compliance with the registration requirement of Section 310(b)(1) of the Act, is the fact that this requirement will immediately harm the sovereignty of the State of Maryland by altering and restricting the manner in which it issues debt, and the timing, size and potential return from said debt, and by abridging its vital sovereign power to borrow money on terms and conditions of its own choosing, which power is reserved to Maryland by the United States Constitution, and by violating the constitutional doctrine which is central to federalism that neither sovereign may tax the other; and that irrespective of the final decision of the United States Supreme Court herein, the violation of Maryland's sovereignty for any period of time

is intolerable to the federal system and will therefore cause irreparable harm to Maryland as a sovereign State.

Further saith the deponent not.

LOUIS L. GOLDSTEIN, COMPTROLLER

On May 2nd, 1983, Louis L. Goldstein personally appeared before me and swore that the matters set forth in this Affidavit were true to the best of his knowledge, information and belief.

Notary Public
Anne Arundel County, Maryland

No. 94, Original

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1982

State of South Carolina,

Plaintiff,

vs.

Donald T. Regan, Secretary of the Treasury of the United States of America,

Defendant.

AFFIDAVIT OF WILLIAM S. JAMES,
TREASURER OF THE STATE OF MARYLAND

State of Maryland
Anne Arundel County

Personally appeared before me, William S. James, who being duly sworn, states:

1. That he is the duly appointed and acting Treasurer of the State of Maryland, whose duties include service, along with the Governor and State Comptroller, on the Board of Public Works, the body that issues the general obligation debt of the State, and that he, as Treasurer, acts as agent of said Board in the general supervision of the issuance of said debt and its maintenance and payment.

2. That Maryland has joined with the State of Texas, and other states, as Amicus Curiae in this action.

3. That the State of Maryland plans to issue approximately $220 million of general obligation bonds within the 12 month period after July 1, 1983, the effective date of the provisions of Section 310(b)(1) of Public Law 97-248, the Tax Equity and Fiscal Responsibility Act of 1982 ("the Act"), which provisions require that State obligations must be issued in fully registered form in order that the interest paid thereon by the State to its lenders remain exempt from federal income taxation.

4. That the proposed $220 million of issues include obligations incurred in order to finance such necessary and vital public projects as schools, colleges, roads, prisons and other general capital construction projects.

5. That in order to comply with the registration requirement of Section 310(b)(1) of the Act, the State of Maryland will have to incur additional initial costs, including registrar's fees, which will be substantially above the costs of issuance if those bonds were issued in coupon form.

6. That while the exact amount of increased cost is unknown at present, because bids will not be received from potential providers of such registration service until approximately three (3) weeks from this date, estimates have been prepared by the employees of State government responsible for same.

7. That, owing to the registration requirement of the Act, these additional costs during the year of issuance for the proposed issues of approximately $220 million will exceed $368,000; if, however, the issue(s) were in coupon form, the same cost would be drastically reduced to approximately $148,000.

8. That it is expected that the State's earnings on the money set aside to pay the interest on said bonds according to the terms of the issues will be reduced, through changes in methods of payment caused by registration, from approximately $600,000 earned during the fiscal year ending June 30, 1982, to $50,000 a year or less for each year the issues are outstanding.

9. That these enormous additional initial costs incurred due to the registration requirement of the Act will result in immediate harm to the State of Maryland in that it will be required to reduce other state general fund expenditures in order to pay such costs.

10. That, additionally, in complying with the registration requirement of the Act, the State of Maryland will have to pay increased costs, which costs will continue through the life of the issue, in registrar's and transfer agent's fees; that, with respect to the proposed issues totaling $220 million, these increased costs will be approximately $64,000 annually, with such costs increasing over the life of the issue.

11. That but for the registration requirement of the Act, Maryland would issue the proposed bonds in coupon form, at an interest rate estimated to be 50 basis points lower than the rate Maryland must pay its lenders on the same bonds in registered form.

12. That even more significant than the increased costs resulting from compliance with the registration requirement of Section 310(b)(1) of the Act, is the fact that this requirement will immediately harm the sovereignty of the State of Maryland by altering and restricting the manner in which it issues debt, and the timing, size and potential return from said debt, and by abridging its vital sovereign power to borrow money on terms and conditions of its own choosing, which power is reserved to Maryland by the United States Constitution, and by violating the constitutional doctrine which is central to federalism that neither sovereign may tax the other; and that irrespective of the final decision of the United States Supreme Court herein, the violation of Maryland's sovereignty for any period of time

is intolerable to the federal system and will therefore cause irreparable harm to Maryland as a sovereign State.

Further saith the deponent not.

WILLIAM S. JAMES, TREASURER

On May 2nd, 1983, William S. James personally appeared before me and swore that the matters set forth in this Affidavit were true to the best of his knowledge, information and belief.

Notary Public
Anne Arundel County, Maryland

No. 94, Original

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM 1982

State of South Carolina,

Plaintiff,

vs.

Donald T. Regan
Secretary of the Treasury
United States of America

Defendant.

AFFIDAVIT OF WILLIAM M. NIXON

State of Georgia
County of Fulton

Personally appeared before me, William M. Nixon, who being duly sworn, states;

1. That he is the duly qualified and acting State Auditor of the State of Georgia, who by virtue of this position, under Georgia Law, is Secretary-Treasurer of the Georgia State Financing and Investment Commission. The Georgia State Financing and Investment Commission is the Constitutionally created Commission that is charged with issuing all General Obligation Bond Debt of the State of Georgia. The Secretary-Treasurer of the Commission is charged with the responsibility of calling the date of General Obligation Bond Sales and preparing Official Statements, bid forms, etc. incident to the sale of such bonds.

2. That the State of Georgia plans to issue $127,125,000.00 of General Obligation Bonds and that these bonds will be level funded over

a five year period. These bonds will be issued within the next three months and will be dated on or after July 1, 1983, the effective date of the provisions of Section 310 (b) (1) of Public Law 97-248, the Tax Equity and Fiscal Responsibility Act of 1982 ("the Act") which provisions require that State obligations must be issued in fully registered form in order that the interest paid thereon by the State to its lenders remain exempt from federal income taxation.

3. That the proposed $127,125,000.00 issue includes obligations incurred in order to finance: the construction and equipping of buildings and facilities under the control of the State Board of Regents of the University System, a school construction program throughout the State of Georgia, the expansion of facilities at the Georgia Ports Authority, equipping of the Georgia World Congress Center, constructing and equipping a Regional Youth Development Center, constructing and equipping the Georgia Public Safety Training Academy and the acquisition and clearing land for the deposit of spoilage in connection with harbor maintenance.

4. That in order to comply with the registration requirement of Section 310 (b) (1) of the Act, the State of Georgia will have to incur increased costs, which costs will continue through the life of the issue in registrar's and transfer agents fees; that with respect to the proposed $127,125,000.00 issue, these increased costs will be $176,200.00.

5. That but for the registration requirement of the Act, Georgia would issue the proposed bonds in coupon form at an interest rate 25 to 30 basis points lower than the rate Georgia must pay its lenders on the same bonds in registered form.

6. That in calculating the difference of 25 basis points for the proposed issue (a net interest cost of 6.25% versus 6.50%) results in a net interest increase of $1,030,288.00 over the life of the proposed issue.

7. That these enormous additional costs due to the registration requirement of the Act will result in immediate harm to the State of Georgia in that it will be required to fund these additional costs over the life of the proposed issue and such costs must be borne by the taxpayers of the State of Georgia.

8. That even more significant than the increased costs resulting from compliance with the registration requirement of Section 310 (b) (1) of the Act, is the fact that this requirement will immediately harm the sovereignty of the State of Georgia by abridging its vital sovereign power to borrow money, which power is reserved to Georgia by the United States Constitution, and by violating the constitutional doctrine which is central to federalism that neither sovereign may tax the other; and that irrespective of the final decision of the United States Supreme Court herein, the violation of Georgia's sovereignty for any period of time is intolerable to the federal system and will cause irreparable harm to the State of Georgia as a sovereign.

FURTHER saith the deponent not.

William M. Dixon
WILLIAM M. DIXON

SWORN to and subscribed before me this 3rd day of May, 1983.

Deana Robinson
Notary Public
State of Georgia

My Commission Expires: February 4, 1985

No. 94, Original

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1982

State of South Carolina,

Plaintiff,

vs.

Donald T. Regan, Secretary of the Treasury of the United States of America,

Defendant.

AFFIDAVIT OF ANTHONY J. SOLOMON

State of Rhode Island)
)
County of Providence)

Personally appeared before me, Anthony J. Solomon, who being duly sworn, states:

1. That he is the duly elected, qualified Treasurer of the State of Rhode Island, whose duties include borrowing and issuance of all state obligations and complete record of all state obligations.

2. That the State of Rhode Island plans to issue approximately $50 million of Capital Improvement Bonds within the next twelve months and after July 1, 1983, the effective date of the provisions of Section 310(b)(1) of Public Law 97-248, the Tax Equity and Fiscal Responsibility Act of 1982 ("the Act"), which provisions require that State obligations must be issued in fully registered form in order that the interest paid thereon by the State to its lenders remain exempt from federal income taxation.

3. That the proposed $50 million issue includes obligations incurred in order to finance various capital improvements.

4. That in order to comply with the registration requirement of Section 310(b)(1) of the Act, the State of Rhode Island will have to incur additional initial costs, including registrar's fees, which will be substantially above the costs of issuance if those bonds were issued in coupon form.

5. That owing to the registration requirement of the Act, these additional costs for the proposed $50 million issue will exceed $95,000.00; if, however, the issue were in coupon form, the same costs would be drastically reduced to approximately $44,750.00.

6. That these enormous additional initial costs incurred due to the registration requirement of the Act will result in immediate harm to the State of Rhode Island.

7. That, additionally, in complying with the registration requirement of the Act, the State of Rhode Island will have to pay increased costs, which costs will continue through the life of the issue, in registrar's and transfer agent's fees; that, with respect to the proposed $50 million issue, these increased costs will be approximately $50,000.00.

8. That but for the registration requirement of the Act, Rhode Island would issue the proposed bonds in coupon form, at an interest rate 30 to 40 basis points lower than the rate Rhode Island must pay its lenders on the same bonds in registered form.

9. That even more significant than the increased costs resulting from compliance with the registration requirement of Section 310(b)(1) of the Act, is the fact that this requirement will immediately harm the sovereignty of the State of Rhode Island by abridging its vital sovereign power to borrow money, which power is reserved to Rhode Island by the United States Constitution, and by violating the constitutional doctrine which is central to

federalism that neither sovereign may tax the other; and that irrespective of the final decision of the United States Supreme Court herein, the violation of Rhode Island's sovereignty for any period of time is intolerable to the federal system and will therefore cause irreparable harm to the Rhode Island as a sovereign.

FURTHER saith the deponent not.

ANTHONY J. SOLOMON

SWORN to and subscribed
before me this 6th day
of May, 1983.

NOTARY PUBLIC OF RHODE ISLAND (L.S.)
My Commission Expires: June 1986

No. 94, Original

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1982

State of South Carolina,

Plaintiff,

vs.

Donald T. Regan, Secretary of the Treasury of the United States of America,

Defendant.

AFFIDAVIT OF ROBERT W. FLANDERS

State of New Hampshire
County of Merrimack

Personally appeared before me, Robert W. Flanders who being duly sworn, states:

1. That he is the duly elected, qualified and acting Treasurer of the State of New Hampshire, whose duties include the issuance of all state debt.

2. That the State of New Hampshire plans to issue approximately fifty-two (52) million of general obligation bonds within the next four (4) months and after July 1, 1983, the effective date of the provisions of Section 310(b) (1) of Public Law 97-248, the Tax Equity and Fiscal Responsibility Act of 1982 ("the Act"), which provisions require that State obligations must be issued in

fully registered form in order that the interest paid thereon by the State to its lenders remain exempt from federal income taxation.

3. That the proposed fifty-two (52) million issue includes obligations incurred in order to finance capital improvements in various departments, capital improvements at the University of New Hampshire, highway improvements, acquisition of rail properties and construction of regional vocational education centers.

4. That in order to comply with the registration requirement of Section 310(b)(1) of the Act, the State of New Hampshire will have to incur additional initial costs, including registrar's fees, which will be substantially above the costs of issuance if those bonds were issued in coupon form.

5. That owing to the registration requirement of the Act, these additional costs for the proposed fifty-two(52) million issue will exceed $10,000.00.

6. That these enormous additional initial costs incurred due to the registration requirement of the Act will result in immediate harm to the State of New Hampshire in that it will be required to increase expenditures and cause a greater deficit or to adjust downward its appropriations and expenditures in other areas.

7. That, additionally, in complying with the registration requirement of the Act, the State of New Hampshire will have to pay increased costs, which costs will continue through the life of the issue, in registrar's and transfer agent's fees; that, with respect to the proposed fifty-two (52) million issue, these increased costs will be approximately $100,000.00.

8. That but for the registration requirement of the Act, New Hampshire would issue the proposed bonds in coupon form, at an interest rate 25 to 50 basis points lower than the rate New Hampshire must pay its lenders on the same bonds in registered form.

9. That even more significant than the increased costs resulting from compliance with the registration requirement of Section 310(b)(1) of the Act, is the fact that this requirement will immediately harm the sovereignty of the State of New Hampshire by abridging its vital sovereign power to borrow money, which power is reserved to New Hampshire by the United States Constitution, and by violating the constitutional doctrine which is central to federalism that neither sovereign may tax the other; and that irrespective of the final decision of the United States Supreme Court herein, the violation of New Hampshire's sovereignty for any period of time is intolerable to the federal system and will therefore cause irreparable harm to New Hampshire as a sovereign.

FURTHER saith the deponent not.

Robert W. Flanders
ROBERT W. FLANDERS

THE STATE OF NEW HAMPSHIRE
Merrimack County SS.

May 6, A.D.1983

the above ROBERT W. FLANDERS personally appeared and made oath that the above statement by him/~~her~~ subscribed is, in his/~~her~~ belief, true.

Before me Martha M. Custer
~~Justice of Peace~~
Notary Public

MARTHA M. CUSTER, Notary Public
My Commission Expires June 30, 1988

NO. 94, Original

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1982

State of South Carolina,

Plaintiff,

vs.

Donald T. Regan, Secretary of the Treasury of the United States of America,

Defendant.

AFFIDAVIT OF C. W. HOUSER

State of Texas *
*
County of Travis *

Before us, the undersigned Notary Public, and the Senior Cashier of First City National Bank of Austin (hereinafter, the Bank), on this day personally appeared C. W. Houser, known to us, and after being duly sworn on his oath deposed and said:

1. I am Senior Vice President of First City National Bank of Austin and have been actively involved in municipal bond procedures for banks in Texas for 38 years. The Bank is one of 61 banks in Texas which together comprise First City BAN Corp., a bank holding company, all of said banks being involved actively in the processing of municipal bonds issued in the State of Texas.

2. The Bank is the third largest bank in Austin with assets of $610,000,000. The Bank serves as paying agent for 362 issuers of municipal bonds.

3. In order to comply with the provision of law that all municipal bonds be issued in registered form for the interest thereon to remain tax-exempt, the Bank must install a computer hardware system costing $123,000. Additionally, the Bank must hire two more employees to process the registrations. The Bank has estimated the cost of initial compliance with registration requirements to be approximately $130,000.

4. This cost will be passed on to the issuers of municipal bonds, along with additional fees sufficient to make a profit, in the form of the Bank's fee as registrar to the issuer.

5. Based on my experience in the field of municipal bonds, I estimate that the costs of issuance of bonds will rise between 25% and 50% for the average issuer where the Bank is utilized as registrar.

6. Those issuers of bonds which will be hardest hit by the registration requirement will be the smaller issuers that traditionally have used local banks as paying agents. Those smaller issuers will now have to utilize larger, possibly non-local, banks with the computer capacity to deal with bond registration and will pay correspondingly higher fees for that capacity.

7. The Bank is one of 61 banks comprising one bank holding company in the State of Texas. There are 25 major bank holding companies in Texas (made up of many more individual banks), as

well as certain smaller bank holding companies and a few non-affiliated banks large enough to undergo the necessary expense to comply with registration requirements. Based on my experience in the banking industry's role in the issuance of municipal bonds, I think it reasonable to assume that the added costs to each of those banks will be passed along to issuers of bonds in the form of registrar fees charged by the banks, resulting in substantially greater costs of issuance to those issuers.

Further deponent saith not.

Attest: Senior Cashier

C. W. Houser
Senior Vice President

(SEAL)

Sworn to and subscribed before me this 22 day of April, 1983.

Notary Public in and for Travis County, The State of Texas

My commission expires:

(SEAL)

No. 94, Original

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1982

State of South Carolina,

Plaintiff,

vs.

Donald T. Regan, Secretary of the Treasury of the United States of America,

Defendant.

MEMORANDUM IN SUPPORT OF MOTION FOR PRELIMINARY INJUNCTION

On February 9, 1983, the plaintiff herein, the State of South Carolina, filed its Motion for Leave to File Complaint, its Complaint with attached exhibits and its supporting Brief asking the Court to exercise original jurisdiction in order to determine whether or not Section 310(b)(1) of Public Law 97-248, the "Tax Equity and Fiscal Responsibility Act of 1982" (the "Act"), violates the United States Constitution in that it abridges South Carolina's power to borrow money and erodes South Carolina's immunity as a sovereign from federal taxation. The provisions of Section 310(b)(1) of the Act are effective as of July 1, 1983, upon which date all State obligations are required to be issued in registered form in order for the interest paid thereon to retain its immunity from federal income taxation. The defendant's response to South Carolina's motion was originally due on or before April 11, 1983, but on April 7, 1983, the United States Solicitor General requested and received an extension to respond until May 11, 1983.

Since the filing of the motion on February 9, 1983, events have occurred which make it imperative that the Court temporarily enjoin the enforcement of the challenged provision. First, as July 1, 1983, approaches, it appears increasingly unlikely that the Court will be able to pass

upon South Carolina's motion and consider and decide the question raised in the complaint before the registration requirement is scheduled to go into effect. Second, South Carolina has now been joined by an additional twenty-four States of the United States in its request to the Court that original jurisdiction be exercised and that Section 310(b)(1) of the Act be declared unconstitutional. See, Amicus Curiae Brief of Texas, Alaska, Arizona, Georgia, Indiana, Iowa, Louisiana, Maryland, Mississippi, Missouri, Montana, Nevada, New Hampshire, North Carolina, North Dakota, Ohio, Oklahoma, Pennsylvania, Rhode Island, Tennessee, Virginia, Vermont, Wisconsin and Wyoming filed May 5, 1983. The fact that fully one-half of the sovereign States of the United States are urging the Court to hear the matter manifests the significance of the challenge. The urgency of the challenge is illustrated by the affidavits attached both to the complaint and to the amicus curiae brief which detail the adverse financial effect which the challenged provision will have. Moreover, as the representative affidavits attached hereto reflect, South Carolina and many other States have now determined that State obligations need to be issued in the next several months and after July 1, 1983, a fact which compounds the immediacy of the controversy and the necessity of preserving the status quo until the Court is able to consider and decide the merits of the controversy. Finally, South Carolina submits that as July 1, 1983, draws nearer without a resolution of the fundamental constitutional question which it has raised by its challenge to Section 310(b)(1) of the Act, the loss of one of the cornerstones of its sovereignty becomes less a threat and more a reality.

While a preliminary injunction is extraordinary relief which is not granted except in cases clearly warranting it [see, e.g., Connecticut v. Massachusetts, 282 U.S. 660 (1931)], the Court has declared that:

> Where the questions presented by an application for an interlocutory injunction are grave, and the injury to the moving party will be certain and irreparable if the application be denied and the final decree be in his favor, while if the injunction be granted the injury to the opposing party, even if the final decree be in his favor, will be inconsiderable,..., the injunction usually will be granted.... Ohio Oil Company v. Conway, 279 U.S. 813 (1929).

That the questions raised by South Carolina's motion for a preliminary injunction are grave cannot be denied. The registration requirement imposed on State obligations by the challenged provision and enforced by the taxability of interest on those obligations if they are not registered will overturn precedents established over one hundred and fifty years ago [see, e.g., Weston v. The City Council of Charleston, 27 U.S. (2 Pet.) 481 (1829)] and will intrude on South Carolina's sovereign borrowing power, a power guaranteed by the United States Constitution, particularly by the Tenth Amendment thereto. Cf., National League of Cities v. Usery, 426 U.S. 833 (1976).

Furthermore, as manifested by the affidavits attached hereto, the injury to South Carolina will be certain and irreparable if the challenged provision is not temporarily enjoined. Apart from the enormously increased costs which will be incurred if the bonds which South Carolina and all other States intend to issue must be in registered form, the injury to State sovereignty is even more significant. To permit the enforcement of the challenged provision for even one day, or in even one instance, would undermine the solemn and basic relationship between State and national governments which the founders of this nation established by means of the United States Constitution. The damage which will result to South Carolina as a sovereign, to all other States as sovereigns and to the federal system itself by the implementation of Section 310(b)(1) of the Act is unascertainable and, accordingly, irremediable. Cf., Youngstown Sheet & Tube Co. v. Sawyer, 343 U.S. 579 (1952).

Finally, South Carolina's likelihood of prevailing on the merits is almost certain in view of the clear, continuing and centuries-old precedents more fully set forth in South Carolina's supporting brief included with its motion herein. See, Motion for Leave to File Complaint, Complaint and Supporting Brief at 44-65.

On the other hand, the defendant's injury, even were he to prevail on the merits, will indeed be inconsiderable, if not totally speculative, if the preliminary injunction is granted. Whatever administrative inconvenience or loss of federal revenues might result if the Court enjoins the implementation of the registration requirement is insignificant, in any balancing of equities, when the integrity of the federal system rests in the balance. Only the preservation of the status quo by means of preliminiary injunctive relief will protect the integrity of the federal system.

South Carolina contends that when it issues its State general obligation bonds, whose proceeds will be expended for schools, penitentiaries, State-run hospitals, universities or highways, it is exercising an essential or core State function. The taxability or non-taxability of many types of bonds issued by the States or their political units may rest upon the will or grace of Congress - but not so here. If the federal system is to be preserved as originally established, South Carolina submits that the Court must uphold its sovereign right to issue general obligation bonds for essential State functions without interference from the national government.

For the foregoing reasons as well as for those contained in the affidavits attached hereto and in the supporting brief included with the original motion herein, the plaintiff respectfully submits that temporary relief is as important as final success here and urges the Court to

issue a preliminary injunction against the implementation and enforcement of Section 210(b)(1) of the Tax Equity and Fiscal Responsibility Act of 1982.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, KAREN LeCRAFT HENDERSON, counsel of record for the plaintiff and a member of the Bar of the Court, do hereby certify that, in accordance with Rule 28.4(a), three (3) copies of the Motion for Preliminary Injunction, Affidavits and Supporting Brief were served on all parties required to be served on this date by depositing same in the United States mail, first-class postage prepaid, and addressed as follows: The Solicitor General of the United States, Department of Justice, Washington, D.C. 20530 and The Honorable Donald T. Regan, Secretary of the United States Treasury, Department of the Treasury, 1500 Pennsylvania Avenue, N.W., Washington, D.C. 20220.

This 9th day of May, 1983.

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NO. 94, Original

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1983

State of South Carolina,

Plaintiff,

vs.

Donald T. Regan, Secretary of the Treasury of the United States of America,

Defendant.

PLAINTIFF'S MOTION FOR LEAVE TO FILE SUPPLEMENTAL MEMORANDUM AND SUPPLEMENTAL MEMORANDUM

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NO. 94, Original

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1983

State of South Carolina,

Plaintiff,

vs.

Donald T. Regan, Secretary of the Treasury of the United States of America,

Defendant.

MOTION FOR LEAVE TO FILE SUPPLEMENTAL MEMORANDUM

Pursuant to Rule 9.6 of the Rules of the Supreme Court of the United States, the plaintiff State of South Carolina respectfully asks leave of the Court to file the Supplemental Memorandum which is submitted herewith. This motion is made in response to the defendant's supplemental memorandum which

he has heretofore moved for leave to file on the assumption that his motion will be granted.

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NO. 94, Original

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Defendant.

PLAINTIFF'S SUPPLEMENTAL MEMORANDUM

This memorandum responds to the defendant's assertion contained in his supplemental memorandum that the Court should in its discretion decline to assume original jurisdiction based on the Anti-Injunction Act and the Declaratory Judgment Act.

The defendant in effect re-argues his original contention. The defendant asserts that the Anti-Injunction Act and the

Declaratory Judgment Act "should govern, or guide" this Court in the exercise of its original jurisdiction. Supplemental Memorandum for the Defendant page 1. Despite his use of the word "guide", he then argues, without citation of authority:

> ...But it hardly follows that every remedial or procedural rule enacted by Congress is inapplicable to original proceedings in this Court, even if the end result is to bar the suit. Id. 3.

In other words, notwithstanding the clear language of Article III, Section 2 of the United States Constitution that "(i)n all cases...in which a State shall be Party, the Supreme Court shall have original Jurisdiction," he continues to assert that the Congress may limit or destroy its mandate. In so doing, he takes a position that the legislative branch may determine a dispute intended by the Constitution to be decided by this Court. His position not only conflicts with the plain meaning of Article III of the Constitution but it destroys the

intent of the framers of the Constitution:

> ...'(T)here is no liberty, if the power of judging be not separated from the legislative and executive powers.' THE FEDERALIST NO. 78 (A. Hamilton).

There are two further comments that we would make in response to the defendant's argument regarding the Anti-Injunction Act and the Declaratory Judgment Act. South Carolina's action relates to taxes because the sanction imposed by the challenged provision relates to taxes. But South Carolina is not a taxpayer within the purview of the two statutes whose prohibition he seeks to apply. Irrespective of whether or not a suit which is not a taxpayer's suit is barred by those two statutes, their prohibition can extend only to those courts whose original jurisdiction the Congress is empowered to regulate. Finally, because South Carolina and the defendant apparently agree that the Court's exercise of original jurisdiction here is a matter solely within

its discretion, the question of whether or not it should be exercised necessarily involves an inquiry into the available alternatives to its exercise. The defendant's suggestion that South Carolina may continue to issue its bearer bonds and then "actively support" a taxpayer who subsequently questions the taxability of the interest is patently unworkable. First, if South Carolina were to continue to issue bearer bonds, they could not be sold while their tax exempt status remains in dispute. If bearer bonds were successfully sold, the interest rate which South Carolina would have to pay would be so exorbitantly high as to impair, perhaps fatally, South Carolina's power to borrow money. 1/

1/ Cf. Weston v. City Council of Charleston, 16 S.C.L. (Harp.) 219, 224 (1824) (Huger, J., dissenting):

> ... It will be in vain for Congress to pass acts authorizing the Secretary of the Treasury to borrow money, if the holders of their stock can be taxed by the States

Contrary to the defendant's statement that "South Carolina has indicated its intention to issue bearer bonds" (Supplemental Memorandum for the Defendant 7, n. 7), South Carolina intends to, and must, continue to issue marketable general obligation bonds. Complaint ¶ 8; Motion for Leave to File Complaint, Complaint & Supporting Brief at 6-7, 13-14, 35. [2/]

[1/] (cont.)
for having lent. Congress may offer ten per cent. for loans but who will lend, if the States can appropriate the whole to their use.

[2/] The $65 Million State Capital Improvement Bonds offered for sale on September 13, 1983, will be fully registered bonds convertible into bearer bonds only if such action would not impair the tax exempt status of the interest of the bonds.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, KAREN LeCRAFT HENDERSON, counsel of record for the plaintiff and a member of the Bar of the Court, do hereby certify that, in accordance with Rule 28.4(a), three (3) copies of the Plaintiff's Motion For Leave To File Supplemental Memorandum And Supplemental Memorandum were served on all parties required to be served on this date by depositing same in the United States mail, first-class postage prepaid, and addressed as follows: The Solicitor General of the United States, Department of Justice, Washington, D.C. 20530 and The Honorable Donald T. Regan, Secretary of the United States Treasury, Department of the Treasury, 1500 Pennsylvania Avenue, N.W., Washington, D.C. 20220.

This 8th day of September, 1983.

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No. 94 Original

In the Supreme Court of the United States

OCTOBER TERM, 1982

STATE OF SOUTH CAROLINA, PLAINTIFF

v.

DONALD T. REGAN, SECRETARY OF THE TREASURY OF THE UNITED STATES OF AMERICA

ON MOTION FOR LEAVE TO FILE COMPLAINT

BRIEF FOR THE DEFENDANT IN OPPOSITION

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QUESTIONS PRESENTED

Section 310(b)(1) of the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 596, amending Section 103 of the Internal Revenue Code of 1954, 26 U.S.C., provides that the interest on certain obligations of a state or political subdivision shall be excluded from gross income only if the obligations are issued in registered form.

The questions presented are whether South Carolina's suit for a declaration that Section 310(b)(1) violates the Tenth Amendment and for an order enjoining its enforcement to prevent the Secretary of the Treasury from assessing taxes on the interest from unregistered state and local obligations is barred by the tax exception to the Declaratory Judgment Act, 28 U.S.C. (Supp. V) 2201, and the Anti-Injunction Act, 26 U.S.C. (Supp. V) 7421(a), and whether that provision is constitutional.

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In the Supreme Court of the United States

OCTOBER TERM, 1982

No. 94 Original

STATE OF SOUTH CAROLINA, PLAINTIFF

v.

DONALD T. REGAN, SECRETARY OF THE TREASURY OF THE UNITED STATES OF AMERICA

ON MOTION FOR LEAVE TO FILE COMPLAINT

BRIEF FOR THE DEFENDANT IN OPPOSITION

JURISDICTION

The original jurisdiction of this Court is invoked under Article III, Section 2, of the Constitution and 28 U.S.C. (Supp. V) 1251. As we shall show (pp. 4-11, *infra*), however, the action in its present form cannot be maintained because the relief sought by South Carolina is barred by statute. At all events, since this suit is one between a state and United States, the jurisdiction of this Court is not exclusive under 28 U.S.C. (Supp. V) 1251(b)(2), and we urge denial of the motion for leave to file.

CONSTITUTIONAL PROVISIONS, STATUTES, AND REGULATION INVOLVED

Article I, Section 8, Article III, Section 2, and Article VI of the United States Constitution; Section 7421 of the Internal Revenue Code of 1954, 26 U.S.C. (& Supp. V); 28 U.S.C. (Supp. V) 2201; Section 310 of the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96

Stat. 595; and Temp. Income Tax Reg. § 5f.103-1, T.D. 7852, 47 Fed. Reg. 51361 (1982), are set forth, in relevant part, in the App., *infra*, 1a-15a.

STATEMENT

1. The State of South Carolina seeks leave to file its complaint to enjoin the Secretary of the Treasury from enforcing Section 310(b)(1) of the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 596 ("1982 Tax Act") insofar as it includes in taxable income of the holders, interest on unregistered general obligations of South Carolina issued after June 30, 1983, and to obtain a declaration that Section 310(b)(1) as so applied is unconstitutional (Mot. 8-9).

The complaint asserts that as one of its essential sovereign functions, South Carolina must borrow money to function effectively as a provider of services essential to its citizens and that, pursuant to Article X, Section 13 of the South Carolina Constitution of 1895 as amended, it is authorized to borrow money and to issue general obligation and other bonds (Mot. 4).

South Carolina further alleges that, after June 30, 1983,[1] Section 310(b)(1) impermissibly imposes conditions upon its sovereign power to borrow money and unconstitutionally impairs the ability of South Carolina to function as a sovereign in violation of the Tenth Amendment (Mot. 5-6).[2]

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[1]Under Section 310(d) (96 Stat. 599), the original effective date of the statute was with respect to obligations issued after December 31, 1982. However, pursuant of Sections 306(b)(2) and 311(d) of the Technical Corrections Act of 1982, Pub. L. No. 97-448, 96 Stat. 2405-2406 and 2412, the effective date was postponed to cover only obligations issued after June 30, 1983.

[2]The complaint (Mot. 6) incorporates by reference an affidavit of the Treasurer of the State of South Carolina, who estimated (*id.* at 16) that if the State were to evidence its borrowings by fully registered bonds it

2. Section 310(b)(1) is not an isolated provision. Rather, it is but one of a number of the provisions of Section 310 (App., *infra*, 3a-6a), by which Congress has sought comprehensively to deal with problems growing out of the existence of bearer bonds, usually with coupons attached, and to bring more nearly to completion the movement away from bearer bonds toward the issuance of registered bonds that began after 1962. It is the common, but not universal, practice currently to issue corporate bonds in registered form.

The principal provisions of Section 310 are as follows: Section 310(a) (96 Stat. 595) amends the Second Liberty Bond Act (31 U.S.C. 757c-5) to provide that, with certain exceptions not relevant here,[3] every obligation of the United States, or of any agency or instrumentality thereof, shall be in registered form.[4] Section 310(b)(1) (96 Stat. 596) adds

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would pay an additional 0.25% interest on its borrowings, while bonds without tax-exempt status would require payment of "approximately 3% to 5% more by way of interest rates" (*id.* at 16-18).

[3]Non-exempted obligations are termed "registration-required obligation," a term that appears in, and is defined in, most of the subsections of Section 310. While the definition varies in the particular statutory context, a composite summary of the statutory definition of "registered-required obligation" is: any obligation other than an obligation which (1) is issued by a natural person; (2) is not of a type issued to the public; (3) has a maturity (at issue) of not more than one year; (4) is the subject of arrangements reasonably designed to ensure that it will be sold (or resold in connection with the original issue) only to a person who is not a United States person; or (5) has interest payable only outside the United States and its possessions and bears on its face a statement that any United States person holding such obligation will be subject to limitations under United States income tax laws.

[4]Each subsection of Section 310 permits "book-entry registration," under which a transfer of the right to principal and interest may be made by book entries, consistent with regulations prescribed by the Secretary. There are existing regulations concerning registration of United States securities (31 C.F.R. 306.2(n), 306.10-306.13) and book-entry procedures (31 C.F.R. 306.115-306.122). Cf. 12 C.F.R. 811.0-811.7.

a new subsection (j) to Section 103 of the 1954 Code to provide that Section 103(a) shall not provide an exemption from federal income tax for interest on any registration-required obligation that is not issued in registered form.[5] Section 310(b)(2) (96 Stat. 596) amends Section 163 of the 1954 Code to deny a deduction for interest paid or accrued on any registration-required obligation not in registered form. Section 310(b)(3) (96 Stat. 597) amends Section 312 of the 1954 Code to provide that the earnings and profits of any corporation (other than certain foreign corporations) shall not be decreased by reason of a payment of interest with respect to which the amendment to Section 163 denies an interest deduction. Section 310(b)(4) (96 Stat. 597) imposes on any person (other than a state or political subdivision thereof) issuing a registration-required obligation not in registered form an excise tax equal to the product of 1% of its principal amount multiplied by the number of years from issuance to its maturity. Section 310(b)(5) (96 Stat. 598) amends Section 165 of the 1954 Code to deny deductions for losses on registration-required obligations that are not issued in registered form. Finally, Section 310(b)(6) (96 Stat. 599) amends Section 1232 of the 1954 Code to provide that gain on the sale or other disposition of a registration-required obligation not issued in registered form shall be treated as ordinary income rather than as capital gain unless the issuance of the obligation was subject to the excise tax imposed by Section 310(b)(4).

ARGUMENT

A. THIS SUIT IS BARRED BY STATUTE

1. This suit—to enjoin the assessment and collection of income taxes, and to obtain a declaratory judgment with respect to taxes—is prohibited by statute. Section 7421(a)

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[5]Temp. Income Tax Reg. § 5f.103-1, T.D. 7852, under Section 103(j) of the 1954 Code (Section 310(b)(1) of the 1982 Tax Act, published in the Federal Register on November 15, 1982 (47 Fed. Reg. 51361), are set forth in the App., *infra*, 12a-15a

of the Internal Revenue Code of 1954, 26 U.S.C. (Supp. V) (App., *infra*, 2a), commonly known as the Anti-Injunction Act, provides, with exceptions not here relevant, that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person". Moreover, while the Declaratory Judgment Act, 28 U.S.C. (Supp. V) 2201 (App., *infra*, 2a-3a), authorizes "any court of the United States" to issue, in appropriate cases, declaratory judgments, it contains an explicit exception "with respect to Federal taxes." Cf. *Bob Jones University* v. *Simon*, 416 U.S. 725 (1974); *Commissioner* v. *"Americans United" Inc.*, 416 U.S. 752 (1974).[6]

The statutory prohibitions against suits "in any court" by any person to enjoin the assessment or collection of taxes and against declaratory judgments with "respect to Federal taxes" do not deprive any taxpayer of complete and effective judicial review of his liability for taxes. Cf. *Bob Jones*

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[6]The statutory exception to the "Federal taxes" limitation on declaratory judgments, *i.e.*, "other than actions brought under section 7428 of the Internal Revenue Code of 1954," refers to the authorization, enacted after the above-cited decisions of this Court, for a determination by the United States Tax Court, the United States Claims Court, or the United States District Court for the District of Columbia, of the initial or continuing classification of an organization as an exempt organization pursuant to Section 501(c)(3) of the 1954 Code.

Section 7478, added to the 1954 Code by Section 336 of the Revenue Act of 1978, Pub. L. No. 95-600, 92 Stat. 2841, authorizes a determination with respect to obligations proposed to be issued by a state or political subdivision thereof, on petition of the prospective issuer and only in the first instance by the Tax Court, "whether such prospective obligations are described in section 103(a)." Section 103(a) of the Internal Revenue Code of 1954 is the provision that excludes from gross income interest on obligations of states and political subdivision thereof. Since "described in section 103(a)" limits the scope of the proceeding to issues of statutory coverage or construction, Section 7478 of the 1954 Code does not authorize in a declaratory judgment action, even in the Tax Court, consideration and determination of such issues as are sought to be advanced here by South Carolina.

University v. *Simon, supra*, 416 U.S. at 746-748. South Carolina is not a taxpayer, but seeks to enjoin collection of income taxes from others,[7] and to have a declaration of the liability of others. Any taxpayer holding obligations of South Carolina may fully and freely litigate the correctness of his income tax liabilities in either the United States Tax Court, a district court of the United States, or the United States Claims Court, and may raise any appropriate constitutional issue. See Sections 6213(a), 7422; 28 U.S.C. 1346(a)(1), 1491; *Flora* v. *United States*, 362 U.S. 145 (1960). This statutory scheme provides a fully adequate procedure for judicial review of tax liability that contemplates no such litigation as South Carolina here seeks to initiate. Hence, South Carolina cannot invoke the jurisdiction of any court, much less the original but not exclusive jurisdiction of this Court under 28 U.S.C. (Supp. V) 1251(b)(2), either to enjoin the assessment or collection of taxes or to obtain a declaratory judgment with respect to taxes.

2. The only exception to the bar of the Anti-Injunction Act is where the taxpayer can show that equity jurisdiction would otherwise be available, and that under no circumstances could the government prevail on the merits of its claim. *Bob Jones University* v. *Simon, supra*, 416 U.S. at 737; *Enochs* v. *Williams Packing & Navigation Co.*, 370 U.S. 1, 7 (1962). That is not the case here. The registration requirement imposed by Section 310 of the 1982 Tax Act is a necessary and proper exercise of several powers granted Congress under Article I of the United States Constitution.

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[7]Section 7421(a) prohibits suits "by any person" to enjoin assessment or collection of taxes, "whether or not such person is the person against whom such tax was assessed." See *Bob Jones University* v. *Simon, supra*, 416 U.S. at 739.

While the statute has long provided that the interest earned on certain[8] state obligations is exempt from federal income taxation, not all transactions with such obligations are exempt from tax. Thus, the gain realized on the sale of such obligations is as taxable as any other capital transaction (*Willcuts* v. *Bunn*, 282 U.S. 216 (1931)), and the transfer of such obligations by gift or at death may give rise to liability for gift or estate taxes. In reporting Section 310 of the 1982 Tax Act,[9] the Senate Finance Committee (1 S. Rep. No. 97-494, 97th Cong., 2d Sess. 242 (1982)) stated:

> The committee believes that a fair and efficient system of information reporting and withholding cannot be achieved with respect to interest-bearing obligations as long as a significant volume of long-term bearer

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[8]Although it is not necessary to address the merits of South Carolina's suit at this time, the authorities seriously question the premise underlying its complaint, viz., that the Constitution requires federal tax exemption on the interest on state obligations. See, *e.g.*, Senate Spec. Comm. on Taxation of Governmental Securities and Salaries, *Taxation of Governmental Securities and Salaries*, S. Rep. No. 2140 (Pt. 1), 76th Cong., 3d Sess. (1940); Kirby, *State and Local Bond Interest*, in 1 House Comm. on Ways and Means, *Tax Revision Compendium* 679 (Comm. Print Nov. 16, 1959). Compare *Graves* v. *New York ex rel. O'Keefe*, 306 U.S. 466 (1939); *Helvering* v. *Gerhardt*, 304 U.S. 405 (1938); and *Helvering* v. *Mountain Producers Corp.*, 303 U.S. 376 (1938); with *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U.S. 429 (1895). Indeed, the interest earned on a number of state obligations (*e.g.*, industrial development bonds and arbitrage bonds) is now subject to federal income tax. See Internal Revenue Code of 1954, 26 U.S.C. (& Supp. V) 103(b) through 103(i).

[9]The provisions that became Section 310 were originally set forth in Section 312 of the Senate Bill. See also H.R. Conf. Rep. No. 97-760, 97th Cong., 2d Sess. 563-565 (1982), and Staff of the Jt. Comm. on Taxation, 97th Cong., 2d Sess., *General Explanation of the Revenue Provisions of the Tax Equity and Fiscal Responsibility Act of 1982*, 189-193 (Jt. Comm. Print 1982).

> instruments is issued. A system of book-entry registration will preserve the liquidity of obligations while requiring the creation of ownership records that can produce useful information reports with respect to both the payment of interest and the sale of obligations prior to maturity through brokers. Furthermore, registration will reduce the ability of noncompliant taxpayers to conceal income and property from the reach of the income, estate, and gift taxes. Finally, the registration requirement may reduce the volume of readily negotiable substitutes for cash available to persons engaged in illegal activities.

What is more, registration of securities will deter violations of 18 U.S.C. 2314 and 2315, dealing with the transportation and disposition of stolen or forged securities, and will facilitate apprehension of violators.

There can be no doubt that Congress can require registration of securities, whoever the issuer, in aid of the exercise of its enumerated powers under Article I. The only question remaining, therefore, is whether despite the explicit terms of the Supremacy Clause of Article VI of the United states Constitution, Section 310(b)(1) imposes an impermissible burden upon the exercise of a necessary function of state government. We believe it does not.

This Court determined long ago that when Congress, pursuant to constitutionally granted authority, controls through taxation specified forms of securities, any state or municipality that chose to exercise its borrowing power through the issuance of securities in those forms did so subject to the tax that Congress had imposed. *National Bank* v. *United States*, 101 U.S. 1 (1880). Not every extension of credit to a government evokes constitutional protection from taxation. Cf. *Smith* v. *Davis*, 323 U.S. 111 (1944). The requirement that securities be issued in registered form if the interest from such securities is to be tax-

exempt in the hands of the lender does not restrict the state's borrowing power. It is not discriminatory against state obligations, since registration is required of similar obligations of the United States, and unregistered corporate obligations deny the issuer an income tax deduction for interest paid and also impose a substantial excise tax.

The Treasurer of South Carolina "estimates" that registration would add 0.25% in interest to the cost of issuance (Mot. 16). But this "estimate" ignores offsetting economies of handling and insurance, resulting from reduced risk of loss or theft, that add to the attractiveness of registered bonds. Indeed, the Treasurer's "estimate" is difficult to reconcile with the fact that corporate issuers in the past 20 years have substantially moved from bearer coupon bonds to registered bonds and that Treasury Bills are now issued in registered form, induced in each case only by considerations of economy and efficiency. See Sebring, *Foreward* to ABA, *Corporate Debt Financing Project* at 1-8 (1967).

In the collection of federal revenues, which are not without many benefits to the states, Congress may require that the state or local governments collect and remit federal taxes on admissions to public parks.[10] It may require that a state officer and a state withhold from the compensation of a state employee the amounts by which the employee was

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[10] *Wilmette Park District* v. *Campbell*, 338 U.S. 411 (1949). The Court has very recently repeated an earlier reference to the management of state parks as clearly a traditional state function. *EEOC* v. *Wyoming*, No. 81-554 (Mar. 2, 1983), slip op. 11; *National League of Cities* v. *Usery*, 426 U.S. 833, 851 (1976).

delinquent in payment of federal taxes,[11] just as the Internal Revenue Code requires that state and local governments withhold and remit current income taxes from the compensation of their employees.[12] Congress may require that a state cover public employees in its unemployment insurance statutes on pain of losing administrative grants and losing also credits to private employers against the federal unemployment tax for contributions to the state's unemployment fund.[13]

The uniform burden borne by nation, states, and corporations incident to the issuance of registered obligations, if there are such burdens, is no greater than the burden incident to employment of the personnel of state government, and touches upon no more central or vital interests. South Carolina has suggested no substantive interest it may have in the issuance of bearer, rather than registered, obligations. Indeed, Section 310(b)(1) does not, in fact, limit, modify, or qualify a state's borrowing power quantitatively or qualitatively. It does not deny to a state's obligations the preferential access to the capital markets resulting from income tax exemption of the interest on those obligations, as do the provisions of Section 103(b)(1) and (c)(1) with respect to industrial development bonds and arbitrage bonds. It does provide, in furtherance of the effective use of the nation's taxing and other powers committed to Congress, that if a state wishes to offer to its lenders the attractive feature of income-tax exemption with respect to the interest on its obligations, it must issue those obligations in registered form.

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[11] *Sims* v. *United States*, 359 U.S. 108 (1959); *Massachusetts* v. *United States*, 296 F.2d 336 (1st Cir. 1961).

[12] 26 U.S.C. (& Supp. V) 3402(a) and 26 U.S.C. 3404.

[13] *New Hampshire* v. *Marshall*, 616 F.2d 240 (1st Cir.), appeal dismissed, 449 U.S. 806 (1980); *County of Los Angeles* v. *Marshall*, 631 F.2d 767 (D.C. Cir.), cert. denied, 449 U.S. 837 (1980).

South Carolina "claim[s] no substantial stake" in issuing its securities in bearer, or unregistered, form other than problematic costs which, "even if they were not largely speculative in their own right" (*EEOC* v. *Wyoming*, No. 81-554 (Mar. 2, 1983), slip op. 13), are entirely comparable to costs incident to employment of state officers and employees that co-existence with the nation requires of the states in the federal union. In sum, there is no serious basis for a claim that South Carolina must be enabled to issue unregistered, rather than registered obligations as an "undoubted attribute of state sovereignty" (*National League of Cities* v. *Usery*, 426 U.S. 833, 845 (1976)), and the proposed complaint accordingly sets forth no arguably substantial constitutional challenge to Section 310(b)(1). *EEOC* v. *Wyoming, supra*; *FERC* v. *Mississippi*, 456 U.S. 742 (1982); *Hodel* v. *Virginia Surface Mining & Reclamation Ass'n*, 452 U.S. 264, 286-288 (1981).

B. IN THE EXERCISE OF ITS DISCRETION, THIS COURT SHOULD DECLINE TO ENTERTAIN THIS SUIT

At all events, even if South Carolina's proposed suit were not barred by the statute, we submit its motion for leave to file a complaint should nevertheless be denied. The complaint is not one alleging a case or controversy between two states within the exclusive jurisdiction of this Court, under 28 U.S.C. (Supp. V) 1251(a), but a dispute between the United States and a state over which this Court has original but not exclusive jurisdiction under 28 U.S.C. (Supp. V) 1251(b)(2). This Court exercises its original jurisdiction sparingly and is particularly reluctant to take jurisdiction of a suit which is not within the exclusive original jurisdiction of the Court. *United States* v. *Nevada*, 412 U.S. 534, 538 (1973); *Illinois* v. *City of Milwaukee*, 406 U.S. 91 (1972); *Ohio* v. *Wyandotte Chemicals Corp.*, 401 U.S. 493 (1971). In our view, South Carolina has failed to show that the

present case qualifies as one of the exceptional situations in which this Court should exercise its extraordinary original jurisdiction.

Assuming arguendo that South Carolina's suit lies in any court, this case is particularly inappropriate for the exercise of this Court's discretionary original jurisdiction. First, given the demands on this Court's original and appellate docket, it seems plain that a district court could hear the case more promptly. This is especially true in light of the fact that to support its claim, South Carolina would undoubtedly seek to introduce evidence of the actual burden imposed upon it by the federal tax statute. Such a proceeding could be more expeditiously conducted at the usual trial court level by a federal district court. Finally, neither the jurisdictional questions nor the constitutional questions presented in this case are of such urgent concern to the entire country as to require a definitive resolution by this Court in the first instance. Cf. *South Carolina* v. *Katzenbach*, 383 U.S. 301, 307 (1966). Hence, in the exercise of its discretion, this Court should decline to entertain this suit.

CONCLUSION

The motion for leave to file a complaint should be denied.

Respectfully submitted.

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MAY 1983

DOJ-1983-05

APPENDIX

CONSTITUTION OF THE UNITED STATES:

ARTICLE I

* * * * *

Section 8. The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defense and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States;

To borrow Money on the credit of the United States;

To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes;

* * * * *

To coin Money, regulate the Value thereof, and of foreign Coin, and fix the Standard of Weights and Measures;

* * * * *

To make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers and all other Powers vested by this Constitution in the Government of the United States, or in any Department or Officer thereof.

ARTICLE III

* * * * *

Section 2. The judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority;—to all Cases affecting Ambassadors, others public ministers and Consuls;—to all Cases of admiralty and maritine Jurisdiction;—to Controversies to which the United States shall be a Party;—to Controversies between two or more States;—between a State and Citizens of another State;—between Citizens of different

States;—between Citizens of the same State claiming Lands under Grants of different States, and between a State, or the Citizens thereof, and foreign States, Citizens or Subjects.

In all Cases affecting Ambassadors, other public Ministers and Consuls, and those in which a State shall be Party, the supreme Court shall have original Jurisdiction. In all other Cases before mentioned, the supreme Court shall have appellate Jurisdiction, both as to Law and Fact, with such Exceptions, and under such Regulations as the Congress shall make.

ARTICLE VI

* * * * *

This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, and Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Internal Revenue Code of 1954, 26 U.S.C. (Supp. V):

Section 7421. PROHIBITION OF SUITS TO RESTRAIN ASSESSMENT OR COLLECTION.

(a) Tax.—Except as provided in sections 6212(a) and (c), 6213(a), 6672(b), 6694(c), and 7426(a) and (b)(1), and 7429(b), no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person against whom such tax was assessed.

28 U.S.C. (Supp. V) 2201. Creation of remedy

In a case of actual controversy within its jurisdiction, except with respect to Federal taxes other than actions brought under section 7428 of the Internal Revenue Code of

1954 * * * any court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought. Any such declaration shall have the force and effect of a final judgment or decree and shall be reviewable as such. Section 310, Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324, 595:

Section 310. OBLIGATIONS REQUIRED TO BE REGISTERED.

(a) UNITED States obligations.—The Second Liberty Bond Act is amended by adding at the end thereof the following new section:

"SEC. 28. (a) Every registration—required obligation of the United States (or of any agency or instrumentality thereof) shall be in registered form.

"(b) For purposes of this section—

"(1) Except as provided in paragraph (2), the term 'registration-required obligation' means any obligation other than obligation which—

"(A) is not of a type offered to the public, or

"(B) has a maturity (at issue) of not more than 1 year.

"(2) The term 'registration-required obligation' shall not include any obligation if—

"(A) there are arrangements reasonably designed to ensure that such obligation will be sold (or resold in connection with the original issue) only to a person who is not a United States person, and

"(B) in the case of an obligation not registered form—

"(i) interest on such obligation is payable only outside the United States and its possessions, and

"(ii) on the face of such obligation there is a statement that any United States person who holds such obligation will be subject to limitations under the United States income tax laws.

"(c)(1) For purposes of subsection (a), a book entry obligation shall be treated as in registered form if the right to principal of, and stated interest on, such obligation may be transferred only through a book entry consistent with regulations prescribed by the Secretary of the Treasury.

"(2) The Secretary of the Treasury shall prescribe such regulations as may be necessary to carry out the purpose of subsection (a) where there is a nominee or chain of nominees."

(b) OTHER OBLIGATIONS.—

(1) OBLIGATIONS MUST BE IN REGISTERED FORM TO BE TAX-EXEMPT.—Section 103 (relating to interest on certain governmental obligations) is amended by redesignating subsection (j) as subsection (k) and by inserting after subsection (i) the following new subsection:

"(j) OBLIGATIONS MUST BE IN REGISTERED FORM TO BE TAX-EXEMPT.—

"(1) IN GENERAL.—Nothing in subsection (a) or in any other provision of law shall be construed to provide an exemption from Federal tax for interest on any registration-required obligation unless the obligation is in registered form.

"(2) REGISTRATION-REQUIRED OBLIGATION.—The term 'registration-required obligation' means any obligation other than an obligation which—

"(A) is not of a type offered to the public,

"(B) has a maturity (at issue) of not more than 1 year, or

"(C) is described in subsection 163(f)(2)(B).

"(3) SPECIAL RULES.—

'(A) BOOK ENTRIES PERMITTED.—For purposes of paragraph (1), a book entry obligation shall be treated as in registered form if the right to the principal of, and stated interest on, such obligation may be transferred only through a book entry consistent with regulations prescribed by the Secretary.

"(B) NOMINEES.—The Secretary shall prescribe such regulations as may be necessary to carry out the purpose of paragraph (1) where is a nominee or chain of nominees."

(2) DENIAL OF DEDUCTION FOR INTEREST IF OBLIGATION NO IN REGISTERED FORM.—Section 163 (relating to deduction for interest) is amended by redesignating subsection (e) the following new subsection:

"(f) DENIAL OF DEDUCTION FOR INTEREST ON CERTAIN OBLIGATIONS NOT IN REGISTERED FORM.—

"(1) IN GENERAL.—Nothing in subsection (a) or in any other provision of law shall be construed to provide a deduction for interest on any registration—required obligation unless such obligation is in registered form.

"(2) REGISTRATION-REQUIRED OBLIGATION.—For purposes of this section—

"(A) IN GENERAL.—The term 'registration-required obligation' means any obligation (including any obligation issued by a governmental entity) other than an obligation which—

"(i) is issued by a natural person,

"(ii) is not of a type offered to the public,

"(iii) has a maturity (at issue) of not more than 1 year, or

"(iv) is described in subparagraph (B).

"(B) CERTAIN OBLIGATIONS NOT INCLUDED.—An obligation is described in this subparagraph if-

"(i) there are arrangements reasonably designed to ensure that such obligation will be sold (or resold in connection with the original issue) only to a person who is not a United States person, and

(ii) in the case of an obligation not in registered form—

"(I) interest on such obligation is payable only outside the United States and its possessions, and

"(II) on the face of such obligation there is a statement that any United States person who holds such obligation will be subject to limitations under the United States income tax laws.

"(C) AUTHORITY TO INCLUDE OTHER OBLIGATIONS.—Clauses (ii) and (iii) of subparagraph (A), and subparagraph (B), shall not apply to any obligation if-

"(i) such obligation is of a type which the Secretary has determined by regulations to be used frequently in avoiding Federal taxes, and

(ii) such obligation is issued after the date on which the regulations referred to in clause (1) take effect.

"(3) BOOK ENTRIES PERMITTED, ETC.—For purposes of this subsection, rules similar to the rules of section 103(j)(3) shall apply."

(3) DENIAL OF EARNINGS AND PROFITS ADJUSTMENT FOR INTEREST ON REGISTRATION-REQUIRED OBLIGATION NOT IN REGISTERED

FORM.—Section 312 (relating to earnings and profits) is amended by adding at the end thereof the following new subsection:

"(m) NO ADJUSTMENT FOR INTEREST PAID ON CERTAIN REGISTRATION-REQUIRED OBLIGATIONS NOT IN REGISTERED FORM.—The earnings and profits of any corporation shall not be decreased by any interest with respect to which a deduction is not or would not be allowable by reason of section 163(f), unless at the time of issuance the issuer is a foreign corporation that is not a controlled foreign corporation (within the meaning of section 957), a foreign investment company (within the meaning of section 124(b), or a foreign personal holding company (within the meaning of section 552) and the issuance did not have as a purpose the avoidance of section 163(f) of this subsection".

(4) EXCISE TAX ON ISSUERS OF REGISTRATION-REQUIRED OBLIGATIONS WHICH ARE NOT IN REGISTERED FORM.—

(A) IN GENERAL.—Subtitle D (relating to miscellaneous excise taxes) is amended by adding after chapter 38 the following new chapter:

"CHAPTER 39—REGISTRATION-REQUIRED OBLIGATIONS

"Sec. 4701. Tax on issuer of registration-required obligation not in registered form.

"Sec. 4701. TAX ON ISSUER OF REGISTRATION-REQUIRED OBLIGATION NOT IN REGISTERED FORM.

"(a) IMPOSITION OF TAX.—In the case of any person who issues a registration-required obligation which is not in registered form, there is hereby imposed on such person on the issuance of such obligation a tax in an amount equal to the product of—

"(1) 1 percent of the principal amount of such obligation, multiplied by

"(2) the number of calendar years (or portions thereof) during the period beginning on the date of issuance of such obligation and ending on the date of maturity.

"(b) DEFINITIONS.—For purposes of this section—

"(1) REGISTRATION-REQUIRED OBLIGATION.—The term 'registration-required obligation' has the same meaning as when used in section 163(f), except that such term shall not include any obligation required to be registered under section 103(j).

"(2) REGISTERED FORM.—The term 'registered form' has the same meaning as when used in section 163(f)."

(B) CONFORMING AMENDMENT.—The table of chapters for subtitle D is amended by inserting after chapter 38 the following:

"Chapter 39. Registration-required obligations."

(5) DENIAL OF DEDUCTION FOR LOSSES ON CERTAIN OBLIGATIONS NOT IN REGISTERED FORM.—Section 165 (as amended by this Act) is amended by redesignating subsection (j) as subsection (k) and by inserting after subsection (i) the following new subsection:

"(j) DENIAL OF DEDUCTION FOR LOSSES ON CERTAIN OBLIGATIONS NOT IN REGISTERED FORM.—

"(1) IN GENERAL.—Nothing in subsection (a) or in any other provision of law shall be construed to provide a deduction for any loss sustained on any registration-required obligation unless such obligation is in registered form (or the issuance of such obligation was subject to tax under section 4701).

"(2) DEFINITIONS.—For purposes of this subsection—

"(A) REGISTRATION-REQUIRED OBLIGATION.—The term 'registration-required obligation' has the meaning given to such term by section 163(f)(2) except that clause (iv) of subparagraph (A), and subparagraph (B), of such section shalll not apply.

"(B) REGISTERED FORM.—The term 'registered form' has the same meaning as when used in section 163(f).

"(3) EXCEPTIONS.—The Secretary may, by regulations, provide that this subsection and subsection (d) of section 1232 shall not apply with respect to obligations held by any person if—

"(A) such person holds such obligations in connection with a trade or business outside the United States,

"(B) such person holds such obligations as a broker dealer (registered under Federal or State law) for sale to customers in the ordinary course of his trade or business,

"(C) such person complies with reporting requirements with respect to ownership, transfers, and payments as the Secretary may require, or

"(D) such person promptly surrenders the obligation to the issuer for the issuance of a new obligation in registered form,

but only if such obligations are held under arrangements provided in regulations or otherwise which are designed to assure that such obligations are not delivered to any United States person other than a person described in subparagraph (A), (B), or (C)."

(6) DENIAL OF CERTAIN GAIN TREATMENT FOR GAINS ON CERTAIN OBLIGATIONS NOT IN REGISTERED FORM.—Section 1232 (relating to bonds and other evidences of indebtedness) is amended by redesignating subsection (d) as subsection (e) and by inserting after subsection (c) the following new subsection:

"(d) DENIAL OF CAPITAL GAIN TREATMENT FOR GAINS ON CERTAIN OBLIGATIONS NOT IN REGISTERED FORM.—

"(1) IN GENERAL.—If any registration-required obligation is not in registered form, any gain on the sale or other disposition of such obligation shall be treated as ordinary income (unless the issuance of such obligation was subject to tax under section 4701).

"(2) DEFINITIONS.—For purposes of this subsection.

"(A) REGISTRATION-REQUIRED OBLIGATION.—The term 'registration-required obligation' has the meaning given to such term by section 163(f)(2) except that clause (iv) of subparagraph (A), and subparagraph (B), of such section shall not apply.

"(B) REGISTERED FORM.—The term 'registered form' has the same meaning as when used in section 163(f)."

(c) TECHNICAL AMENDMENTS.—

(1) Subparagraph (A) of section 103(b)(4) (relating to certain exempt activities) is amended by striking out "if each obligation issued pursuant to the issue is in registered form and".

(2)(A) Paragraph (1) of section 103(h) (relating to certain obligations must be in registered form and not guaranteed or subsidized under an energy program) is amended by

striking out subparagraph (A) and by redesignating subparagraphs (B) and (C) as subparagraphs (A) and (B), respectively.

(B) The subsection heading for subsection (h) of section 103 is amended by striking out "MUST BE IN REGISTERED FORM AND NOT" and inserting in lieu thereof "MUST NOT BE".

(3)(A) Subsection (j) of section 103A (relating to other requirements) is amended by striking out paragraph (1) and by redesignating paragraphs (2) and (3) as paragraphs (1) and (2), respectively.

(B) Subparagraph (B) of section 103A(c)(2) (defining qualified mortgage issue) is amended by striking out "and (f) and paragraphs (2) and (3) of subsection (j)" and inserting in lieu thereof "(f), and (j)".

(c) Subparagraph (C) of section 103A(c)(2) is amended by striking out", and paragraph (1) of subsection (j)".

(D) Subparagraph (C) of section 103A(c)(3) (defining qualified veterans' mortgage bond) is amended by striking out "subsection (j)(1)".

(4) Subparagraph (A) of section 103A(c)(3) (defining qualified veterans' mortgage bond) is amended by striking out "in registered form".

(d) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to obligations issued after December 31, 1982.

(2) LONG-TERM U.S. OBLIGATIONS.—The amendment made by subsection (a) shall apply to obligations issued after the date of the enactment of this Act under the first section of the Second Liberty Bond Act.

(3) EXCEPTION FOR CERTAIN WARRANTS, ETC.—The amendments made by subsection (b) shall not apply to any obligations issued after December 31, 1982, on the exercise of a warrant or the conversion of a convertible obligation if such warrant or obligation was offered or sold outside the United States without registration under the Securities Act of 1933 and was issued before August 10, 1982. A rule similar to the rule of the preceding sentence shall also apply in the case of any regulations issued section 163(f)(2)(C) of the Internal Revenue Code of 1954 (as added by this section) except that the date on which such regulations the effect shall be substituted for "August 10, 1982". Temporary Income Tax Regulations § 5f.103-1 [issued in T.D. 7852, filed in the Office of the Federal Register on November 9, 1982, and published in the issue of the Federal Register for November 15, 1982, 47 Fed. Reg. 51361.]:

§ 5f.103-1 Obligations issued after December 31, 1982, required to be in registered form.

(a) Registration; general rule. Interest on a registration-required obligation (as defined in paragraph (b) of this section) shall not be exempt from tax notwithstanding section 103(a) or any other provision of law, exclusive of any treaty obligation of the United States, unless the obligation is issued in registered form (as defined in paragraph (c) of this section).

(b) Registration-required obligation. For purposes of this section, the term "registration-required obligation" means any obligation except any one of the following:

(1) An obligation not of a type offered to the public. The determination as to whether an obligation is not of a type offered to the public shall be based on whether similar obligations are in fact publicly offered or traded.

(2) An obligation that has a maturity at the date of issue of not more than 1 year.

(3) An obligation issued before January 1, 1983. An obligation first issued before January 1, 1983, shall not be considered to have been issued on or after that date merely as a result of the existence of a right on the part of the holder of such obligation to convert the obligation from registered form into bearer form, or as a result of the exercise of such a right.

(4) An obligation described in § 5f.163-1(c) (relating to certain obligations issued to foreign persons).

(c) Registered form—(1) General rule. An obligation is in registered form if—

(i) The obligation is registered as to both principal and any stated interest and transfer of the obligation may be effected only by the surrender of the old instrument and either the reissuance by the issuer of the old instrument to the new holder or the issuance by the issuer of a new instrument to the new holder, or

(ii) The right to the principal of, and stated interest on, the obligation may be transferred only through a book entry system (as described in paragraph (c)(2) of this section).

(2) Special rule for registration of a book entry obligation. An obligation shall be considered transferable through a book entry system if the ownership of an interest in the obligation is required to be reflected in a book entry, whether or not physical securities are issued. A book entry is a record of ownership that identifies the owner of an interest in the obligation.

(d) Effective date. The provisions of this section shall apply to obligations issued after December 31, 1982, unless issued on an exercise of a warrant for the conversion of a convertible obligation if such warrant or obligation was

offered or sold outside the United States without registration under the Securities Act of 1933 and was issued before August 10, 1982.

(e) Obligation first issued after December 31, 1982, where the right exists for the holder to convert such obligation from registered form into bearer form. [Reserved]

(f) Examples. The application of this section may be illustrated by the following examples:

Example (1). Municipality X publicly offers its general debt obligations to United States persons. The obligations have a maturity at issue exceeding 1 year. The obligations are registration-required obligation under § 5f.103-1(b). When individual A buys an obligation, X issues an obligation in A's name evidencing A's ownership of the principal and interest under the obligation. A can transfer the obligation only by surrendering the obligation to X and by X issuing a new instrument to the new holder. The obligation is issued in registered form.

Examples (2). Municipality Y issues a single obligation on January 4, 1983, in bearer form, to Bank M provided that (i) Bank M will not at any time transfer any interest in the obligation to any person unless the transfer is recorded on Municipality Y's records (except by means of a transfer permitted in (ii) of this example), and (ii) interests in the obligation that are sold by Bank M (and any persons who acquire interests from M) will be reflected in book entries. C, an individual, buys an interest in Y's obligation from Bank M. Bank M records such transfer by reflecting C's ownership on Bank M's books. Bank M receives the interest on principal payments with respect to C's interest in the obligation as agent for book entry system. Since C's interest can only be transferred through a book entry system, the obligation is considered issued in registered form. Interest received by C is excludable from gross income under section 103(a).

Example (3). Municipality Z wishes to sell its debt obligations having a maturity in excess of 1 year. The obligations are sold to Bank N, O, and P, all of which are located in Municipality Z. By their terms the obligations are freely transferable, although each of the banks has stated that it acquired the obligations for purposes of investment and not for resale. Obligations similar to the obligations sold by Municipality Z are traded in the market for municipal securities. The obligations issued by Municipality Z are of a type offered to the public and are therefore registration-required under paragraph 5f.103-1(b).

(g) Cross-references. See section 103A(j)(1) for the registration requirement of certain mortgage subsidy bonds issued after December 31, 1981, and § 6a.103A-1(a)(5) for the definition of registered form for such obligations issued after December 31, 1981, and on or before December 31, 1982. See also section 103(h) (requiring registration of certain energy bonds issued on or after October 18, 1979.

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No. 94, Original

In the Supreme Court of the United States

OCTOBER TERM, 1983

STATE OF SOUTH CAROLINA, PLAINTIFF

v.

DONALD T. REGAN, SECRETARY OF THE TREASURY OF THE UNITED STATES OF AMERICA

ON MOTION FOR LEAVE TO FILE COMPLAINT

MOTION OF DEFENDANT FOR LEAVE TO FILE SUPPLEMENTAL MEMORANDUM AND SUPPLEMENTAL MEMORANDUM

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In the Supreme Court of the United States

OCTOBER TERM, 1983

No. 94, Original

STATE OF SOUTH CAROLINA, PLAINTIFF

v.

DONALD T. REGAN, SECRETARY OF THE TREASURY OF THE UNITED STATES OF AMERICA

ON MOTION FOR LEAVE TO FILE COMPLAINT

MOTION OF DEFENDANT FOR LEAVE TO FILE SUPPLEMENTAL MEMORANDUM

Pursuant to Rules 9.5 and 9.6 of the Rules of the Court, the Solicitor General, on behalf of the Secretary of the Treasury, moves for leave to file the annexed supplemental memorandum.

In response to South Carolina's Motion for Leave to File an Original Complaint, we primarily invoked the Anti-Injunction Act, 26 U.S.C. (Supp. V) 7421(a), and the Declaratory Judgment Act, 28 U.S.C. (Supp. V) 2201, as barring the proposed suit. See Br. in Opp. 4-11. In its Reply Brief (at 3), the State apparently agrees that the cited statutes would preclude "this action in any lower court," but argues that, because "South Carolina has no forum in which to contest the constitutionality of the challenged provision" (*ibid.*), this Court should hear the case. The major premise of this plea is that the Anti-Injunction Act and the Declaratory Judgment Act must be deemed inapplicable to any original suit in this Court, since "Congress may neither enlarge nor diminish

the original jurisdiction of the United States Supreme Court" (*id.* at 1).

We have had no occasion to respond to that argument. Yet, it may be the focal issue for consideration by the Court at the forthcoming oral argument on the Motion for Leave to File. In these circumstances, it seems appropriate now to submit a short written statement on this point and we accordingly seek leave to do so.*

Granting this motion will not require postponing the date of oral argument. Even the plaintiff deemed it necessary to reply, the case could be heard at the October session. We fully appreciate South Carolina's concern that the Court determine as soon as convenient whether it will entertain the tendered Complaint and we have no wish to delay that decision. We believe that a written submission now may aid the Court in reaching an earlier resolution of the jurisdictional issue.

Respectfully submitted.

REX E. LEE
Solicitor General

AUGUST 1983

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* Shortly after the Court set down for oral argument the Motion for Leave to file an Original Complaint, the parties were advised by the Clerk that no further briefs could be submitted except upon special leave granted by the Court. The State of South Carolina, as plaintiff, has not sought to supplement its earlier submission, and, on behalf of the defendant, we have accordingly deemed it inappropriate to ask permission to submit fuller argument on the merits, confining the attached memorandum to a jurisdictional issue previously not addressed. On the other hand, we recognize that the Court is free to reject the plaintiff's claim on the merits without granting leave to file the Complaint. See *Ohio* v. *Kentucky*, 410 U.S. 641, 644 (1973); *California* v. *Washington*, 358 U.S. 64 (1958); *Alabama* v. *Texas*, 347 U.S. 272 (1954). We urge that result here if the Court concludes that no jurisdictional barrier stands in the way. Should the Court wish further briefing on the merits with a view to considering such a disposition, we, of course, stand ready to make an additional submission.

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In the Supreme Court of the United States

OCTOBER TERM, 1983

No. 94, Original

STATE OF SOUTH CAROLINA, PLAINTIFF

v.

DONALD T. REGAN, SECRETARY OF THE TREASURY OF THE UNITED STATES OF AMERICA

ON MOTION FOR LEAVE TO FILE COMPLAINT

SUPPLEMENTAL MEMORANDUM FOR THE DEFENDANT

The present memorandum is addressed to a single question: Whether the statutes barring any federal court from entertaining an injunctive or declaratory action inhibiting the assessment or collection of federal taxes should govern, or guide, this Court in the exercise of its original jurisdiction.

1. For present purposes, we assume: (1) that South Carolina has asserted a sufficient interest of its own to have constitutional standing to bring the proposed suit in the name of the State; (2) that, given that only prospective relief is sought against an official's enforcement of a statute alleged to violate the Constitution, sovereign immunity does not bar the action; and (3) that the case is otherwise within this Court's original jurisdiction.[1]

[1] The federal judicial power extends to this suit on two independent grounds: it is a "case[] in * * * Equity, arising under

So, also, it is common ground that, except for the Anti-Injunction Act (26 U.S.C. (Supp. V) 7421(a)) and the Declaratory Judgment Act (28 U.S.C. (Supp. V) 2201), the appropriate district court would have concurrent jurisdiction with this Court to entertain the suit, since Congress has preserved exclusive original jurisdiction in this Court only for "controversies between two or more States." 28 U.S.C. (Supp. V) 1251(a). Finally, as we have already sufficiently argued (Br. in Opp. 4-11) and as South Carolina apparently concedes (Reply Br. 1-5), we begin with the premise that, in any other federal court, this action would be barred by the Anti-Injunction Act and the Declaratory Judgment Act.[2]

On these assumptions, the only remaining issue at this stage is whether, as a matter of law or of judicial discretion, the Court should invoke the Acts of Congress just cited to deny leave to file the Complaint. In our view, the Anti-Injunction Act and the Declaratory Judgment Act are fully applicable to this Court, as their lan-

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[the] Constitution" (the Tenth Amendment), as well as a "controvers[y] * * * between a State and [a] Citizen[] of another State." Art. III, § 2, cl. 1. This Court's original jurisdiction attaches because the case is one "in which a State [is a] party." Art. III, § 2, cl. 2.

[2] We note that South Carolina, correctly, does not invoke as an exception to the bar against declaratory actions, a provision enacted in 1978, 26 U.S.C. (Supp. V) 7478. That provision only permits a suit in the Tax Court for "a declaration whether * * * prospective obligations are described in section 103(a)"—which, in turn exempts from federal income taxation interest on general State and municipal bonds (26 U.S.C. 103(a)). Section 7478 is obviously inapplicable here since Section 103(a) has effectively been amended by the Tax Equity and Fiscal Responsibility Act of 1982 to make clear that most State and municipal bonds issued in bearer form are no longer embraced by Section 103(a). See Section 103(j), added by Section 310(b)(1) of the 1982 Tax Act (96 Stat. 596). Br. in Opp. App. 4a. There is no issue of statutory construction presented here and it seems clear that Section 7478 is confined to matters of coverage and was not intended to permit the constitutional challenge now mounted by South Carolina.

guage plainly suggests.[3] But, alternatively, we submit that the Court may, and should, look to those statutes in determining whether, as a matter of judicial discretion, it will exercise its original jurisdiction and, accordingly, should refuse to entertain this action.

2. We do not here question the several *dicta* in decisions of this Court to the effect that Congress cannot take away the original jurisdiction conferred on the Court by the Constitution itself—albeit other courts may be given concurrent power to exercise the same jurisdiction. See *Marbury* v. *Madison*, 5 U.S. (1 Cranch) 137, 174 (1803); *Martin* v. *Hunter's Lessee*, 14 U.S. (1 Wheat.) 304, 332 (1816); *Kentucky* v. *Dennison*, 65 U.S. (24 How.) 66, 86 (1861); *Bors* v. *Preston*, 111 U.S. 252, 261 (1884); *Ames* v. *Kansas*, 111 U.S. 449, 464 (1884); *Wisconsin* v. *Pelican Insurance Co.*, 127 U.S. 265, 300 (1888); *California* v. *Southern Pacific Co.*, 157 U.S. 229, 261 (1895); *California* v. *Arizona*, 440 U.S. 59, 65-66 (1979). See, also, *South Carolina* v. *Katzenbach*, 383 U.S. 301, 357 n.1 (1966) (Black, J., dissenting in part). But it hardly follows that every remedial or procedural rule enacted by Congress is inapplicable to original proceedings in this Court, even if the end result is to bar the suit.

It is clear, of course, that Congress' refusal "to waive the Nation's sovereign immunity" "binds[s] this Court even in the exercise of its original jurisdiction." *California* v. *Arizona*, *supra*, 440 U.S. at 65. We do not suppose anyone would assert that uniform conditions attaching to such a waiver are inapplicable when the suit is filed here.[4] It would be strange, indeed, if a State plain-

[3] The Anti-Injunction Act in terms embraces "any court" (26 U.S.C. (Supp. V) 7421(a)); the Declaratory Judgment Act on its face likewise runs to "any court of the United States" (28 U.S.C. (Supp. V) 2201), which, of course, includes this Court (28 U.S.C. (Supp. V) 451).

[4] In *California* v. *Arizona*, *supra*, the Court expressed serious doubt whether a waiver of sovereign immunity could exclude this Court. We do not fully understand how granting exclusive juris-

tiff, suing under the Tucker Act or the Quiet Title Act, could, by successfully invoking this Court's original jurisdiction, avoid the limitations provisions applicable to it in the lower courts. See *United States* v. *Louisiana*, 127 U.S. 182, 185, 192 (1888); *Block* v. *North Dakota*, No. 81-2337 (May 2, 1983). Nor do we appreciate why the result should not be the same, in cases of concurrent jurisdiction, where the time bar is not imposed as a condition of lifting sovereign immunity. See *Block* v. *North Dakota*, *supra*, slip op. 13-18.

The same principle, it seems to us, applies to other procedural barriers uniformly imposed on plaintiffs in the federal courts, whether the rule proscribes filing too soon rather than too late, or limits available remedies. After all, the original jurisdiction of this Court exists primarily to afford the States a forum appropriate to their sovereign status; but, to serve that end, the door need be no wider than it would be in other federal courts.[5] If, as is

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diction to a district court (or any other tribunal) over actions that previously were barred by sovereign immunity in *all* federal courts can be said to "withdraw" (440 U.S. at 65) or "limit" (*id.* at 66) this Court's original jurisdiction. Indeed, the opinion in *United States* v. *Louisiana*, 123 U.S. 32, 36-37 (1887) can be read as indicating that, with respect to actions otherwise barred by sovereign immunity, Congress may confine a State plaintiff to a lower court without violating Article III. See, also *State of Louisiana* v. *United States*, 22 Ct. Cl. 85, 91 (1887). The Court may wish to reconsider the broad dictum of *California* v. *Arizona* (insofar as it goes beyond the Quiet Title Act) before States with claims under the Tucker Act or the Tort Claims Act, or the Internal Revenue Code, are emboldened to invoke this Court's original jurisdiction, notwithstanding provisions of the Judicial Code apparently restricting such suits to lower courts. See 28 U.S.C. (& Supp. V) 1346(a)(1), 1346(a)(2), 1346(b), 1491; 26 U.S.C. (& Supp. V) 6213(a), 7422. But, however that may be, nothing in *California* v. *Arizona* suggests that different remedial or procedural rules apply to a suit filed here instead of a lower court with concurrent jurisdiction.

[5] We except, of course, those rare categories of cases within the federal judicial power and the original jurisdiction of this Court which Congress has withheld from the lower federal courts, either by declaring this Court's jurisdiction exclusive (controversies between two States, see 28 U.S.C. (Supp. V) 1251(a)), or simply by failing to vest jurisdiction in any other court (*e.g.*, State law claims

well settled, a State is not excused from procedural requirements when it sues in the lower courts (*e.g.*, *Block* v. *North Dakota*, *supra*), there is no obvious reason why like restrictions should not be applicable when it invokes the original jurisdiction of this Court.

It is familiar history that this Court has repeatedly declined to hear cases concededly within its original jurisdiction, effectively erecting a threshold requirement that the controversy be of sufficient "magnitude." *E.g.*, *Arizona* v. *New Mexico*, 425 U.S. 794, 796-797 (1976); *United States* v. *Nevada*, 412 U.S. 534, 538 (1973); *Illinois* v. *City of Milwaukee*, 406 U.S. 91, 93-94 (1972); *Ohio* v. *Wyandotte Chemicals Corp.*, 401 U.S. 493, 501 (1971); *Massachusetts* v. *Missouri*, 308 U.S. 1, 19-20 (1939). See generally *New York* v. *New Jersey*, 256 U.S. 296, 299, 309 (1921). So, also, the Court's Rules adopt, albeit as a "guide," the Federal Rules of Civil Procedure to govern original actions (Rule 9.2), and the Court has applied the principle of those Rules in determining whether the suit may proceed for lack of an indispensable party (*e.g.*, *Idaho ex rel. Evans* v. *Oregon*, 444 U.S. 380 (1980)) and in resolving motions to intervene (*e.g.*, *Arizona* v. *California*, No. 8, Original (Mar. 30, 1983)), slip op. 8. We take it for granted that in deciding whether to exercise original jurisdiction, the Court may likewise invoke non-constitutional prudential doctrines, whether standing or ripeness or prospective mootness or comity or finality, and, accordingly, may decline to intervene prematurely. See, *e.g.*, *California* v. *Texas*, 457 U.S. 164, 168-169 (1982).

To be sure, it may be answered that, while the Court itself is free to fashion restraints on the exercise of its original jurisdiction, the Congress is not. But that is a

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asserted by a State against citizens of another State or aliens, see *Ohio* v. *Wyandotte Chemicals Corp.*, 401 U.S. 493, 498 n.3 (1971)). But this is no such case, since the claim is one "arising under the Constitution," in principle within the jurisdiction of the district courts (28 U.S.C. (Supp. V) 1331), and one as to which this Court's original jurisdiction is not exclusive (28 U.S.C. (Supp. V) 1251(b)(3)).

questionable proposition. The Court, no more than Congress, can amend the Constitution by depriving States of access to a jurisdiction there conferred for their benefit. The explanation of this Court's discretionary actions therefore must be that Article III does not preclude procedural rules which sometimes effectively close the door to a State plaintiff. And, if this is so, it is not apparent why, within like boundaries, Congress cannot fashion those rules.

Presumably, neither the Congress nor the Court can, in the name of procedure, eliminate an entire category of jurisdiction which the Constitution vests in this Court. Thus, we may assume that it would be impermissible to promulgate a rule barring all original suits challenging the constitutionality of Acts of Congress, or even only tax statutes. But there is nothing in Article III that forbids specifying how and when such a challenge shall be entertained. The Anti-Injunction Act and the Declaratory Judgment Act do no more than postpone a constitutional attack against revenue measures. Indeed, for at least a century, the rule against enjoining the collection of federal taxes has been justified in this Court on the ground that the availability of a refund suit provides an adequate remedy. *Snyder* v. *Marks*, 109 U.S. 189, 193-194 (1883); *Bob Jones University* v. *Simon*, 416 U.S. 725, 746-748 (1974). See generally P. Bator, P. Mishkin & D. Shapiro, *Hart and Wechsler's, The Federal Courts and the Federal System* 332-335 (2d ed. 1973). The result is not a withdrawal of subject-matter jurisdiction, but merely a limitation of remedies and a restriction on timing.

Neither the Anti-Injunction Act nor the Declaratory Judgment Act prevents a State, as taxpayer, from invoking the original jurisdiction of this Court, after assessment or payment, to contest any federal tax as an unconstitutional exaction.[6] If, in the present context, no

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[6] This is not to say that, so far as a refund suit is permissible only by virtue of a waiver of sovereign immunity, Congress cannot restrictively lift the bar and open only lower courts to such suits. See note 4, *supra*.

original suit will lie, it is only because South Carolina is not the taxpayer and will not be the proper party to challenge the assessment or claim a refund, and the bond interest recipient cannot invoke this Court's original jurisdiction. But that is a fortuitous result, in no way directly attributable to the statutes we now invoke. And, of course, the constitutionality of Section 310 of the Tax Equity and Fiscal Responsibility Act of 1982 (96 Stat. 595) can be litigated elsewhere in due course. See Br. in Opp. 6 and note 7, *infra*.[7]

In sum, we submit the bar of the Anti-Injunction Act and its counterpart in the Declaratory Judgment Act are properly viewed as announcing a procedural rule that does not discriminate against this Court's original jurisdiction and does not impermissibly narrow the constitutional grant of Article III. We do not suppose that, by invoking this Court's original jurisdiction, a State can avoid the barrier of the Norris-LaGuardia Act (29 U.S.C. 52) and Congress' grant of primary jurisdiction to the National Labor Relations Board to obtain a labor injunction, or overcome the limitations announced in Section 2283 of the Judicial Code to enjoin judicial proceedings that may adversely affect the State or its citizens.[8]

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[7] We note that the issue on the merits will not be mooted by general State acceptance of the incentive in favor of registration of bonds given by the 1972 Tax Act. South Carolina has indicated its intention to continue issuing bearer bonds. Complaint, para. 8, at Motion 6-7; Motion 13-14, 35-37. Other States may do likewise, at least until the validity of the 1972 Tax Act is settled. Nor need South Carolina stand aside while the issue is litigated in a taxpayer suit. Nothing prevents South Carolina or any other affected State from actively supporting the taxpayer plaintiff in a test case in the Tax Court or a refund suit in the district court or the Claims Court.

[8] These scenarios may seem far-fetched, but recent experience teaches that this Court's original jurisdiction is likely to be invoked in once unexpected contexts. See, *e.g.*, *California* v. *West Virginia*, 454 U.S. 1027 (1981) (football contract); *California* v. *Texas*, 454 U.S. 886 (1981) (the medfly); *Idaho* v. *Vance*, 434 U.S. 1031 (1978) (Panama Canal Treaty); *Alabama* v. *Connally*, 404 U.S. 933 (1971) (religious tax exemptions); *Massachusetts* v. *Laird*, 400 U.S. 886 (1970) (the Vietnam War); *Alabama* v. *Finch*,

The same approach should be followed here.[9]

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396 U.S. 552 (1970) (school desegregation enforcement). It is not difficult to imagine situations in which a State might wish to apply to this Court when other federal courts are barred from granting relief and its own courts are unable or unwilling to do so.

Thus, in the case of a labor dispute, State tribunals may be inhibited by State law or federal pre-emption from issuing an injunction, the State government or one of its institutions may be the employer or otherwise directly affected by the dispute, and its claim may rest on federal law or the prospective defendants may be citizens of another State, thereby bringing the controversy within this Court's original jurisdiction. (We assume, notwithstanding the failure of the Judicial Code to so provide (28 U.S.C. (Supp. V) 1251) and contrary indications in some of the Court's opinions (*e.g., California* v. *Southern Pacific Co.*, 157 U.S. 229, 261-262 (1895); *New Mexico* v. *Lane*, 243 U.S. 52, 58 (1917); *Texas* v. *Interstate Commerce Commission*, 258 U.S. 158, 163 (1922)), that this Court enjoys concurrent original jurisdiction of *all* cases within the federal judicial power, not barred by sovereign immunity, where a State is a party, including a suit founded on federal law by a State against its own citizens. See *United States* v. *Texas*, 143 U.S. 621, 642-645 (1892); *Monaco* v. *Mississippi*, 292 U.S. 313, 321, 329-330 (1934)).

So, also, a State, made defendant in another State's court (see *Nevada* v. *Hall*, 440 U.S. 410 (1979)), might well ask this Court to enjoin those proceedings in favor of an original suit here. Or the State may wish to abort a private lawsuit in its own courts implicating its sovereign interests with a view to proceeding by an original action in this Court in the name of the State (assuming its claim is against citizens of another State or is founded on federal law).

To be sure, the Court could rebuff all such attempts even without invoking the Norris-LaGuardia Act or Section 2283. But if these barriers are operative of their own force, the Court will be spared the case-by-case screening otherwise required in disposing of motions for leave to file original complaints.

[9] Like the Anti-Injunction Act and the Declaratory Judgment Act (see note 3, *supra*), the Norris-LaGuardia Act expressly runs to "any court of the United States" (29 U.S.C. 52), and Section 2283 of the Judicial Code is presumably likewise addressed to all federal courts ("A court of the United States may not * * *"). This is, of course, to be contrasted with the Tax Injunction Act (28 U.S.C. 1341) and the Johnson Act (28 U.S.C. 1342) which only inhibit "[t]he district courts" from premature interference with the collection of State taxes or the implementation of State rate orders. By

3. We have argued that the statutory restraint on premature interference with federal tax collection embodied in the Anti-Injunction Act and the Declaratory Judgment Act is fully applicable to the exercise of this Court's original jurisdiction without offending Article III. Our reasoning has been that Congress, equally with the Court itself, is constitutionally free to promulgate binding procedural rules that regulate, without destroying, the exercise of that jurisdiction. But the Court may deem it unnecessary to reach that question, preferring to rest on its discretion.

As we have said, the Court has always deemed itself authorized to decline to hear a particular case within its original jurisdiction if prudential considerations counseled self-restraint. Surely, the Court is entitled to take into account long-standing congressional policy reflected in procedural statutes in reaching its decision whether to exercise this unusual jurisdiction. Indeed, we would expect the Court to give great deference to a legislative directive against premature judicial interference. Quite aside from the sound reasons underlying the Anti-Injunction Act and its corollary in the Declaratory Judgment Act, it would be anomalous for this Court, necessarily more sparing in the exercise of original jurisdiction, to become the haven for suits that cannot be entertained in lower courts with concurrent jurisdiction.[10]

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their very terms, the latter provisions do not control the exercise of this Court's original jurisdiction. See *Maryland* v. *Louisiana*, 451 U.S. 725, 745 n.21 (1981). But see pages 9-10, *infra*.

[10] South Carolina taxes us with inconsistency in arguing, on the one hand, that the Anti-Injunction Act and the Declaratory Judgment Act bar the present suit in any court, and then suggesting, on the other hand, that the case be remitted to a district court. Reply Br. 3-4. This is disingenuous. Our plea for denial of leave to file here in favor of a district court forum was plainly stated as an alternative argument, in the event the Court should hold, contrary to our primary contention, that the statutes invoked do not bar the suit. Br. in Opp. 11-12. To the extent that South Carolina concedes that the Anti-Injunction Act and the Declaratory Judg-

Thus, we submit the Court can and should follow the rule of the Anti-Injunction Act as a matter of discretion, even if not strictly bound to do so.

For the reasons stated here and in our Brief in Opposition, the Court should deny leave to file the tendered Original Complaint.

Respectfully submitted.

REX E. LEE
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AUGUST 1983

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ment Act preclude the action, as now framed, in any lower court, our alternative submission is moot. What we *do* continue to assert is that this Court should decline jurisdiction in favor of a taxpayer suit, after assessment or payment, in the Tax Court, the district court, or the Claims Court. See 26 U.S.C. (& Supp. V) 6213(a), 7422; 28 U.S.C. (& Supp. V) 1346(a)(1), 1491.

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IN THE
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OCTOBER TERM, 1982

State of South Carolina,

Plaintiff,

vs.

Donald T. Regan, Secretary of the Treasury of the United States of America,

Defendant.

REPLY BRIEF OF PLAINTIFF

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No. 94, Original

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1982

State of South Carolina,

Plaintiff,

vs.

Donald T. Regan, Secretary of the Treasury of the United States of America,

Defendant.

REPLY BRIEF OF PLAINTIFF

QUESTIONS PRESENTED

I. Can the Court's original jurisdiction provided for by Article III, Section 2 of the United States Constitution be restricted by federal statutes?

II. Should the Court in its discretion exercise original jurisdiction here?

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ARGUMENT

I. The Court's original jurisdiction provided for by Article III, Section 2 of the United States Constitution cannot be restricted by federal statutes.

The second paragraph of Article III, Section 2 of the United States Constitution provides as follows:

> In all Cases affecting Ambassadors, other public Ministers and Consuls, and those in which a State shall be Party, the supreme Court shall have original Jurisdiction. In all other Cases before mentioned, the supreme Court shall have appellate Jurisdiction, both as to Law and Fact, with such exceptions, and under such Regulations as the Congress shall make.

The defendant asserts that, notwithstanding this constitutional provision, the present action is barred by two federal statutes, the Anti-Injunction Act [26 U.S.C. 7421(a)] and the Declaratory Judgment Act [28 U.S.C. 2201], both of which prohibit litigation with respect to federal taxes.

But Congress may neither enlarge nor diminish the original jurisdiction of the United States Supreme Court. In California v.

Southern Pacific Railroad Co., 157 U.S. 229 (1895), the Court, relying on Marbury v. Madison, 5 U.S. (1 Cranch), 60 (1803), declared:

> It was held at an early day that Congress could neither enlarge nor restrict the original jurisdiction of this court.... 157 U.S. at 261.

See also, Wisconsin v. Pelican Insurance Co., 127 U.S. 265 (1888); South Carolina v. Katzenbach, 383 U.S. 301 at 357 n.1 (1966) (Black, J., dissenting); California v. Arizona, 440 U.S. 59 (1979); see generally, 12 MOORE'S FEDERAL PRACTICE ¶ 350.01[2]; 17 WRIGHT, MILLER & COOPER, FEDERAL PRACTICE AND PROCEDURE § 4043. This action, being one in which a State is a party and arising under the United States Constitution, is within the Court's original jurisdiction. Accordingly, neither the Anti-Injunction Act nor the Declaratory Judgment Act has any application to the right of the Court to hear and

determine this action. [1]

The defendant also argues that, assuming the Court has jurisdiction, it should decline to exercise it because the jurisdiction is not exclusive. See, Brief in Opposition at 11-12. In reality, the defendant actually reinforces the correctness of South Carolina's statement that, unless the Court accepts jurisdiction, South Carolina has no forum in which to contest the constitutionality of the challenged provision. See, Motion for Leave to File Complaint at 38-39. The defendant has effectively pointed out the statutory barriers which face this action in any lower court. He should not be allowed to assert on the one

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[1] Congress itself has recently observed that it has no power to withdraw the Court's original jurisdiction. In enacting the Diplomatic Relations Act of 1978, which changed the Court's original jurisdiction of actions involving ambassadors or foreign states from exclusive to concurrent, the Senate Judiciary Committee report concluded that "Congress may not deny to the Supreme Court jurisdiction which is expressly granted by the Constitution." S. REP. No. 1108, 95th Cong., 2d Sess., reprinted in 1978 U.S. CODE CONG. & AD. NEWS 1941, 1947.

hand that the Court should decline jurisdiction because of its non-exclusivity and at the same time argue the applicability of the statutes which prohibit the hearing of this action in a lower federal court.

South Carolina's standing arises from the United States Constitution and the defendant asks the Court to reject that standing based on statute. But the intent of the framers of the Constitution to keep the original jurisdiction of the Court intact and beyond the power of Congress to change is manifested by the clear language of Article III, Section 2 which expressly authorizes Congress to regulate only the appellate jurisdiction of the Court. As Alexander Hamilton observed, the Constitution ensures the sovereign States a forum whose dignity parallels their position in the federal system established by that document. **THE FEDERALIST PAPERS, No. 81 (Hamilton); see also, deTocqueville, DEMOCRACY**

IN AMERICA (Doubleday & Co. 1969) at 149-150.[2/]

To argue, as the defendant appears to do, that Congress can oust South Carolina not only from the lower federal courts but from the United States Supreme Court itself would nullify Section 2 of Article III and leave the sovereign States a right without a remedy.

II. The Court in its discretion should exercise original jurisdiction here.

The defendant also addresses the question of the extent of the burden imposed upon South Carolina by the registration requirement. See, Brief in Opposition at 10-11. While

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[2/] "The Supreme Court has been given higher standing than any known tribunal, both by the nature of its rights and by the categories subject to its jurisdiction.... Without them, the Constitution would be a dead letter; it is to them that the executive appeals to resist the encroachment of the legislative body, the legislature to defend itself against the assaults of the executive, the Union to make the states obey it, the States to rebuff the exaggerated pretensions of the Union ...."(Emphasis in original).

South Carolina will not reargue its position here, it does emphasize that the central question it raises is the power of Congress to subject the obligations of South Carolina to tax, as a consequence of non-registration or otherwise. [3/] This question cannot be resolved by weighing the regulatory burden borne by the States against inconvenience or lost revenues to the federal government. The framers of the Constitution sought to establish not a monarchy but a federal system whose very nature contemplates that degrees of inconvenience will necessarily result to the co-equal sovereigns. Because South Carolina's challenge goes to the essence of federalism,

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[3/] The defendant's reliance on Merchant's National Bank of Little Rock v. U.S., 101 U.S. 1 (1880), is completely misplaced. There, State bank notes used as currency were subject to federal taxation because the United States Constitution provides for an exclusive national currency. And in Smith v. Davis, 323 US 111 (1944), the Court upheld the ad valorem tax imposed by Georgia on federal open accounts because the Court found that those accounts did not constitute obligations of the United States to which tax immunity attached. See, Brief in Opposition at 8.

that is, the relative powers of the State and the United States, it cannot be answered by declaring that the challenged provision must be enforced in order to convenience the national government.

The Court has the power to hear this case. As the defendant himself points out [see, Brief in Opposition at 4-6], there is no other forum available to South Carolina in light of the statutory restrictions which are applicable to the lower federal courts. Twenty-four States have joined with South Carolina in urging the Court to assume original jurisdiction because of the substantial and direct constitutional question involved. Accordingly, South Carolina submits that the case is appropriate for the Court's exercise of its original jurisdiction.

CONCLUSION

To sum up,

(1) If the important constitutional question at issue is to receive judicial

review at all, this action must be heard by the United States Supreme Court;

(2) Article III, Section 2 of the Constitution establishes the Court's jurisdiction; and

(3) The very nature of the federal system precludes the defendant's argument of inconvenience to the national government.

For the reasons stated herein and in its brief in chief, South Carolina submits that the relief sought should be granted.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, KAREN LeCRAFT HENDERSON, counsel of record for the plaintiff and a member of the Bar of the Court, do hereby certify that, in accordance with Rule 28.4(a), three (3) copies of the Reply Brief of Plaintiff were served on all parties required to be served on this date by depositing same in the United States mail, first-class postage prepaid, and addressed as follows: The Solicitor General of the United States, Department of Justice, Washington, D.C. 20530 and The Honorable Donald T. Regan, Secretary of the United States Treasury, Department of the Treasury, 1500 Pennsylvania Avenue, N.W., Washington,D.C. 20220.

This 17 day of May, 1983.

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No. 94, Original

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

STATE OF SOUTH CAROLINA,

Plaintiff,

vs.

DONALD T. REGAN, Secretary of the Treasury of the United States of America,

Defendant.

MOTION FOR LEAVE TO FILE A BRIEF *AMICUS CURIAE* AND *AMICUS CURIAE* BRIEF

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September 1983

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

No. 94, Original

STATE OF SOUTH CAROLINA,

Plaintiff,

vs.

DONALD T. REGAN, Secretary of the Treasury of the United States of America,

Defendant.

Motion for Leave to File Brief *Amicus Curiae*

The City of Baltimore and the National Institute of Municipal Law Officers hereby respectfully move for leave to file the annexed brief *amicus curiae* in the above-captioned case.

Amicus City of Baltimore is a political subdivision of the State of Maryland. *Amicus* National Institute of Municipal Law Officers is the national organization of civil attorneys for cities in the United States and other political subdivisions of the States. The City of Baltimore and the other cities and political subdivisions whose attorneys are members of said *amicus* regularly issue bonds for their governmental purposes. The issue in this case is whether the United States may constitutionally tax the interest on such bonds if they are not registered. Briefs heretofore submitted in the case also raise the broader question whether the United States may constitutionally tax the interest on such bonds whether or not they are registered.

All political subdivisions have a vital interest in the answers to these questions because (1) the taxation of their unregistered bonds would effectively prevent them from issuing such bonds and thereby deprive them of the option to do so even if they determine that it is more advantageous in the exercise of their governmental func-

tions; and (2) the taxation of the interest on their bonds in any event will impose on them a heavy burden of cost and of potential regulation by the United States of their exercise of their governmental activities.

While the order of this Court dated June 13, 1983 sets down argument at this time solely on the jurisdictional question presented by South Carolina's motion for leave to file its complaint, it is deemed appropriate to seek leave to file the annexed brief on the merits because the defendant in his Motion for Leave to File a Supplemental Memorandum asserted the Court's power "to reject plaintiff's claim on the merits without granting leave to file the Complaint" and "urge[d] that result if the Court concludes that no jurisdictional barrier stands in the way." (p. 2, fn.)

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

No. 94, Original

STATE OF SOUTH CAROLINA,

Plaintiff,

vs.

DONALD T. REGAN, Secretary of the Treasury of the United States of America,

Defendant.

Statement

The bond registration requirement here in issue is an example of how the power to tax involves the power to destroy State and municipal options which are perfectly lawful. The provision is in the Internal Revenue Code of 1954 ("IRC"), §103(j). It was enacted under the revenue-raising power of Congress (Const. Art. I, §8 cl. 1). Yet nobody can believe that it was expected that any revenues would be derived from it. The purpose and effect was and is to compel the issuance of bonds in registered form whether or not any State or City finds it advantageous to use bearer instruments.

The rule of *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U.S. 429, 585, 602, 652, 158 U.S. 601, 630, 685, 693 (1895), is that state and local government bond interest is constitutionally immune from federal income taxation. Plaintiff State has unequivocally invoked the rule in its brief supporting its Motion for Leave to File Complaint (pp. 44, 50, 60-63), and the defendant has inferentially questioned the rule in a footnote in his Brief in Opposition (p. 7).

The sole inquiry should be whether the tax penalty on the issuance of state and municipal bonds is within any recognized exception to the *Pollock* rule.

It is a truism that tax-exempt borrowing is less expensive borrowing. The corollary is that the loss of tax ex-

emption means higher costs, which, at a minimum, mean either greater state and municipal dependence on federal largesse or less public services, higher local taxes and charges, and even the inability to borrow at all.

But on a higher plane, the immunity rule protects the balance between the States and the National Government in our delicately balanced federal system, a balance to which this Court has committed itself. *South Carolina* v. *United States*, 199 U.S. 437, 448 (1905). Whether or not the power to tax involves the power to destroy, it certainly involves the power to inhibit and the power to control.

What began in 1913 as a three-line exemption[1] has grown in IRC §103 to 16 pages of qualifications and exceptions[2] and to 82 pages of sometimes baffling Treasury Regulations thereunder.[3] We shall give examples of the way state government activity has thus been controlled, some of questionable validity, but nevertheless complied with in order to issue the bonds at all.

Our concern is that a statutory exemption alone is an insufficient barrier to control-by-taxation and that any denigration of the *Pollock* doctrine in this case would encourage Congressional and Treasury intrusions at the expense of state and local self-government.

Facts

The only fact in dispute in this case is the utility of IRC §103(j). The Senate Finance Committee said of the provision, "registration will reduce the ability of noncompliant taxpayers" to evade taxes, and "may reduce the volume of readily negotiable substitutes for cash available to persons engaged in illegal activities."[4] Tax-evaders and criminals are not so easily discouraged.

IRC §103(j) applies only to bonds issued on or after July 1, 1983. This leaves over $450 billion of outstanding bearer bonds with varying maturities extending in many

[1] Revenue Act of 1913, §II, B. 38 Stat. 168.
[2] In the Prentice Hall compilation, June 1, 1983 Edition.
[3] 26 CFR, pp. 499-581.
[4] S. Rep. No. 67—494, 97th Cong. 2d Sess. 242 (1982).

cases for 30 years or more.[5] We cannot speculate on what the needs of the underworld or tax evaders may be for bearer bonds, but it is obvious that for at least a generation they can be fully met by hundreds of billions of dollars of outstanding bonds, to which IRC §103(j) does not apply.

Thus, on the "plus" side we have a non-existent cure in our time. On the "minus" side, the consequences to the States and cities occur immediately. They have no choice but to issue bonds in registered form. The market will not accept bearer bonds at tax-exempt yields so long as IRC §103(j) is in force.

If certificates are used, as in the case of corporate, foreign and most federal bonds, then great and continuing cost burdens are thrust on the issuer. (Affidavit in support of the motion (Para 8), and affidavits in the appendix to the *amicus curiae* brief of Texas and 23 other States.) But it is obvious and within the Court's judicial knowledge. Many more certificates will have to be printed initially so as to have an ample supply to issue to subsequent transferees over the life of the bonds. Every transfer involves a cost in processing it, recording it on the registration records, and executing and mailing the new certificate. All these costs of transfer are avoided in the traditional bearer bond system.

As for interest payments on coupon bonds, the issuer makes a single timely deposit with its paying agent of all interest due on all the bonds, and on the due date each bondholder can deposit his coupons with his own bank for collection, just as in the case of a check to his order. The issuer's costs of payment are modest. But in the case of registered bonds, there is the added cost of mailing and processing each interest payment check to each bondholder.

If a non-certificated, book entry, form of registration is used, the transfer costs can be reduced, but the additional interest payment costs are the same.

Nor can the state or local government issuer escape those added costs by passing them on to its bondholders.

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[5] Solomon Brothers, "1983 Prospects for Financial Markets", p. 26.

Any attempt to do that will at once be reflected in a correspondingly lower price for its bonds on original issue.

Nothing appears in the legislative history to quantify either these immediate and certain cost burdens on state and local governments, nor the conjectural enhancement of federal revenues. Any remote federal gain from limiting improper uses of bearer bonds, can be but a tiny fraction of the certain and immediate cost burden thrust on states and cities.

Congress did not consider any alternatives to achieve its stated purpose. We submit that identification of bondholders can be achieved without registration and even for outstanding as well as future issues.

One more effective system could be based on a requirement that the issuer's paying agent retain records of the persons to whom interest and principal payments are made and reveal them to the Internal Revenue Service on proper request. Add to this a requirement that any such person shall disclose, on request, the identity of his vendor, and that any such vendor, in turn, shall disclose his vendor, etc., and it becomes possible to construct a chain of ownership as informative as registration (which itself is susceptible to manipulation by the use of "dummies").

The fact is that the holder of bearer bonds with bearer coupons reveals his identity when he collects the interest. He encloses the coupons in an envelope on the back of which he identifies himself and gives the number of his bank account. He then deposits this envelope with his own bank, which transmits the coupons to the issuer's paying agent for collection, and credits the bondholder's bank account.

The same process occurs at the maturity of the bond for the principal amount due.

There is no constitutional objection to requiring the paying agent to reveal the ownership thus disclosed.

The Constitution should not be interpreted to sanction punitive taxation of state policy decisions when it is unnecessary for the fulfillment of the federal purpose.

The impact of a tax on municipal bond interest rates was the subject of a trial in *Shamberg* v. *Commissioner*, 3 T.C. 131 (1944) *aff'd* 144 F.2d 998 (2d Cir. 1944), *cert. den.* 323 U.S. 792 (1945). The Commissioner's press release described the case as a "test action intended ultimately to prove in the courts that the Federal Government has the right under the Constitution to tax the income from state and municipal securities." [6]

Both the Treasury's and the taxpayer's testimony agreed that an interest rate increase would ensue. The taxpayer's witnesses established differentials of about 44% of the then yields on tax exempt bonds. Treasury witnesses' conceded about 30%. In constitutional terms this difference was irrelevant; the conceded burden was substantial.

The Court may well take judicial notice of that fact. It appears to have done so in the case of proposed state taxes on federal bonds in *Bank of Commerce* v. *New York City*, 2 Black 620, 631 (1863); *Farmers & M. Savings Bank* v. *Minnesota*, 232 U.S. 516, 527 (1914); *Missouri* v. *Gehner*, 281 U.S. 313, 321 (1930). The same judgment is implied in this year's decision in *American Bank & T. Co.* v. *Dallas County*, 51 U.S.L.W. 5181, 5188, (U.S. July 5, 1983) Col. 2 last Para. in which a Texas tax on national bank shares was upset under R.S. 3701 because it was reasonable for Congress to conclude that the tax unduly burdens federal obligations "by threatening to diminish their value."

In *National Life Ins. Co.* v. *United States*, 277 U.S. 508, 528 (1928), Justices Brandeis, Holmes and Stone, dissenting, said, "It is true that the tax-exempt privilege is a feature always reflected in the market price of bonds. The investor pays for it." The majority did not disagree.

If the differential on outstanding bonds is about 30% of the exempt rate, then on outstanding debt of some $500 billion[7], even if the average interest rate is only 6% or some $30 billion, the States and local governments are

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[6] Brief (in this Court) in Opposition to Petition for a Writ of Certiorari (October Term, 1944, No. 707), p. 13. The case was, however, ultimately decided on statutory ground.

[7] Solomon Brothers, op. cit. *supra* fn. 6.

being spared some $9 billion a year by reason of the exemption of their bond interest.[8]

Higher state and local borrowing costs, if not offset by federal grants, only can be met by higher taxes and charges or by reduced services or by curtailed borrowing, voluntarily or involuntarily.

Sometimes, however, taxes cannot be increased. "The notion that a city has unlimited taxing power is, of course, an illusion." *Faitoute Iron & Steel Co.* v. *City of Asbury Park,* 316 U.S. 502, 509 (1942).

The fragility of local finances under some circumstances is stressed by the enactment by Congress of three successive Municipal Bankruptcy Acts. See *Ashton* v. *Cameron County W.I. Dist.,* 298 U.S. 513 (1936); *United States* v. *Bekins,* 304 U.S. 27 (1938); 11 U.S.C.A. 101 et seq. (1976).

The 1976 Municipal Bankruptcy Act was enacted in the wake of New York City's financial travail.

The consequences of default are not limited to bondholders. The issuer's short term credit disappears when it is most needed. Salaries and wages are impacted and positions pruned; employee morale is shattered; recruitment of able replacements is impaired. Maintenance of infrastructure is deferred and highway bridges collapse; social services are curtailed; classroom size is increased; garbage collection is reduced; police and fire protection is cut back. All these threats to public health and safety would be either caused or hastened and prolonged if distressed municipal borrowers were compelled to shoulder, in addition, the increased cost of taxable borrowings.

The consequence of the added interest cost would not be terminated once the state or municipal borrower succeeded in issuing its bonds at the higher interest rate. Having assumed the added obligation, it would have weakened its resistance to any subsequent jar to its economy.

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[8] On the trial in *Shamberg, supra,* the two sides did not agree on the size of any corresponding loss. Taxpayers witnesses testified that it would be less than the issuers' gain. Treasury witnesses testified to the contrary.

The Court recognized this in *James* v. *Dravo Contracting* Co., 302 U.S. 134, 152-153 (1937), when it said

> "the doctrine of immunity with respect to government bonds • • • would directly affect the government's obligation as a continuing security. Vital considerations are there involved respecting the permanent relations of the government to investors in its securities and its ability to maintain its credit."

Dravo cited *Pollock* for the conclusion that a tax on bond interest "would operate on the power to borrow before it is exercised". This prior effect occurs particularly when the increase in interest cost resulting from taxability would make it impossible for local governments with marginal credit to borrow at all by pushing costs beyond their capacity to meet. It would also apply to revenue bonds to finance projects payable out of charges on the users. Additional debt service caused by taxation in these cases could often make impossible the projected coverage of debt service by future revenues, and thus the tax would abort the project.

In our time it is not uncommon for bills in Congress imposing a tax on some categories of municipal bonds to be introduced with effective dates at or before the time of introduction. A recent example was the introduction in 1979 by the House Ways and Means Committee Chairman of H.R. 3712 to tax the interest on certain municipal bonds to finance mortgages to homeowners (Cf. IRC §103A).

Bills of this type operate on "the power to borrow before it is exercised" even before there is any Congressional enactment. The market must take into consideration the possibility that the bill will be enacted.

The same principle would operate if this Court in this case were to question the *Pollock* rule. Investors remember that in 1942 the Secretary of the Treasury proposed and the Congress debated repeal of the exemption of the interest on state and local government bonds already outstanding[9] as well as future issues. If this Court were to

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[9] Hearings on H.R. 7378 before the Senate Finance Committee, 77th Cong., 2d Sess. pp. 3-7.

question the constitutional inhibition against taxing the interest, the fear of future attempts would push up interest rates, no matter what assurances were given by the President and Congressional leaders that they contemplated no general taxation of the interest.

Summary of Argument

Point I argues that no exception to the established bond interest immunity rule permits Congress to require that bonds issued to finance governmental activities must be registered or forfeit that immunity.

We do not claim that the bond immunity rule is absolute. In other applications of the basic doctrine of tax immunity the Court has limited it to situations where it would not withdraw traditional sources of federal taxation. This is the justification for taxing certain bonds defined as "industrial development bonds" (IRC §103(b)) and "arbitrage bonds" (IRC §103(c)).

However, bearer bonds do not withdraw traditional sources of federal taxation. They do not add one cent to the volume of public debt which has traditionally been beyond the power of Congress to tax. Unlike the other categories, it is not their use by the States and cities which is supposed to impact the federal revenue base, but their misuse by a few holders in ways already unlawful.

Point II traces the history in this Court of the rule, originating in *Pollock*, that it is unconstitutional for the Federal Government to tax state and municipal bond interest. The rule has never been questioned here. Whenever the Court declined to extend basic state tax immunity to some other activity, it pointedly preserved the bond interest immunity. Cases cited by the defendant's footnote 8 in its Brief in Opposition (p. 7) to imply the contrary turn out to be *reaffirmations* of the rule. The Point then deals with the philosophic basis for the rule by demonstrating the enormous degree of control over state governmental operations which would flow from the power to tax and the concomitant power to classify by exemption and to regulate by conditions.

Point III adds the history of the Sixteenth Amendment. Ratification was achieved only after the Amendment's sponsors, in Congress and other forums, publicly assured the States that the Amendment would *not* authorize such taxation of their bond interest. It would be a breach of faith with the States, which relied on such assurances to complete ratification, for Congress to assert or this Court to find authority anywhere in the Constitution for such a tax.

ARGUMENT

POINT I

The scope of the immunity of state and local government bond interest from federal taxation.

We do not contend that the immunity of state bond interest is absolute. For the basic reciprocal tax-immunity rule to apply to any state activity, it must satisfy the test announced in *Helvering* v. *Gerhardt*, 304 U.S. 405, 419 (1938), as refined by the prevailing Justices in *New York* v. *United States*, 326 U.S. 572, 586 (1946).

New York v. *United States* was the last case in this Court to propound a test for the proper application of state tax immunity. The only exception it allowed was where the claimed immunity might withdraw traditional sources from the federal taxing power.

While, as we shall show in Point II, as a general rule the borrowing power satisfies this test, it can be used in ways which do not satisfy it.

Congress has identified three such situations in taxing certain "industrial development bonds" and all "arbitrage bonds" (IRC §103(b) and (c)), and in limiting the exemption of family mortgage subsidy bonds" (IRC §103A).

Each of these provisions was preceded by threatened expansion of tax-exempt bonds in novel areas. Revenue bonds to finance multi-million dollar loans to high-credit private industries with no municipal financial or functional involvement were spreading.[10] They were mere con-

[10] Bond Buyer, July 8, 1963.

duits of the tax exemption to the private users. They could, if not checked, displace taxable corporate bonds. We may question the breadth of the definition of "industrial development bonds" in IRC §103(b)(2) and the wisdom and even validity of some of the exceptions and conditions, but it remains true that Congress was seeking in 1968 to deal with a threatened erosion of a traditional federal tax source.

The same is true as to "arbitrage bonds". The trigger was a proposal by a state university to issue $300 million of bonds, devote $40 million needed for a new project and invest the remaining $260 million in Federal Government bonds at sufficiently high yields so that the investment earnings would cover all debt service requirements on the whole $300 million issue.[11] Such programs could multiply the volume of tax-exempt bonds eight-fold.

However, these exceptions to stem massive withdrawals of federal tax sources cannot, as defendant implies (Brief in Opp. p. 7, fn. 8), justify taxation of the interest on unregistered bonds which involve no such withdrawal.

Restrictions on "industrial development bonds" and "arbitrage bonds" were justified on the basis of what the States and cities themselves might do that would erode a traditional federal tax base. But the only misuse of bearer bonds is ascribed not to the States and cities but to others acting unlawfully.[12]

The Finance Committee's justification for IRC §103(j) does not match any known exception to the basic immunity rule.

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[11] Bond Buyer, April 19, 1966.
[12] See footnote 5, *supra*.

POINT II

This Court has decided and never retreated from the rule that the National Government lacks the constitutional power to tax the interest on the bonds of the States and their agencies. The reason for the rule applies with full force today.

The basic constitutional immunity of municipal bond interest was decided by this Court unanimously in two decisions in *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U.S. 429; 158 U.S. 601, 630 (1895).

Never has this decision been questioned by this Court. Indeed, whenever the Court withdrew a prior application of the basic immunity or declined to extend it to a new example, it carefully refrained from questioning the bond interest immunity rule of the *Pollock* case, and said so.

Thus, *Collector* v. *Day*, 11 Wall. 113 (1871) applied the immunity rule to state and local governmental salaries and that application was denied in *Helvering* v. *Gerhardt*, 304 U.S. 405 (1938). Defendant asks the Court to compare *Gerhardt* with *Pollock* (Brief in Opp., p. 7, fn. 8). And so do we. *Gerhardt*, in effect, reaffirmed *Pollock* by citing it as a proper case for immunity. 304 U.S. at 417.

Graves v. *New York ex rel. O'Keefe*, 306 U.S. 466 (1939), also cited by defendant merely made the *Gerhardt* rule reciprocal, allowing the States to tax federal salaries.

In the area of taxation of income derived by a lessee from lands leased to him by a government, immunity was allowed first in *Gillespie* v. *Oklahoma*, 257 U.S. 501 (1922) and was withdrawn in *Helvering* v. *Mountain Producers Corp.*, 303 U.S. 376 (1938), which the defendant also asks the Court to compare with *Pollock*, and so do we.

Bond immunity was there expressly distinguished and *Pollock* cited, 303 U.S. at 387, as "bearing directly upon the exercise of the borrowing power of the Government."

In permitting taxation of governmental contractors, the Court made the same distinction in favor of *Pollock*, in *Metcalf & Eddy* v. *Mitchell*, 269 U.S. 514, 522 (1926). And in *James* v. *Dravo Contracting Co.*, 302 U.S. 134,

152-153 (1937), the Court did the same thing, saying of the *Pollock* doctrine:

> "Vital considerations are there involved respecting the permanent relations of the government to investors in its securities and its ability to maintain its credit,—considerations which are not found in connection with contracts made from time to time for the services of independent contractors."

There was, thus, in the late 1930's a retreat in some areas from application of the reciprocal constitutional immunity, doctrine—but *no* retreat from the acceptance of *Pollock* and its reasoning. See also *Hale* v. *Iowa State Board,* 302 U.S. 95, 107 (1937); *New York ex rel. Cohn* v. *Graves,* 300 U.S. 308, 315 (1937); *Plummer* v. *Coler,* 178 U.S. 115, 117 (1900); *Greiner* v. *Lewellyn,* 258 U.S. 384, 387 (1922).

In 1938 the Senate established a Special Committee on Taxation of Governmental Securities and Salaries (S.R. 303, 75th Cong., 3d Sess.). It is Part 1 of the Report of that Committee that the defendant cites (Brief in Opp. p. 7) for his statement that "the authorities seriously question the premise underlying its (plaintiff's) complaint, viz. that the Constitution requires federal tax exemption on the interest on state obligations." (S. Rep. No. 2140).

However, of the six Senators on the Committee, only three joined in that aspect of the report (Part 1, p. 16) and its recommendation was rejected by the Senate after a full debate on its constitutionality.[13]

Part 2 of the Report was an elaborate defense of the constitutional bond immunity rule. It closely followed a brief submitted to the Committee by the attorneys general of 39 states[14] and by your present *amicus curiae,* the National Institute of Municipal Law officers.

The most serious threat to the States' constitutional immunity from federal taxation occurred in *New York* v. *United States,* 326 U.S. 572 (1946). The Court on October 8, 1945, requested counsel on reargument to consider

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[13] 86 Cong. Rec. 18199-18203, 18458-18472, 18550-18560, 18562-18563, 18565, 18577-18583, 18593-18621.

[14] Including, incidentally, Earl Warren of California.

specific questions, including one whether a non-discriminatory Federal tax could constitutionally apply to "any state property or activity or the income derived by the state from them."

The Court's questions provoked *amicus curiae* briefs by the attorneys general of 47 States and by your present *amicus*, National Institute of Municipal Law Officers.

The judgment was that New York was required to pay the excise tax. But only Justices Frankfurter and Rutledge would have permitted "nondiscriminatory" taxation of state property, activities, and incomes. Six Justices disagreed.

Four Justices concurred in the judgment but rejected the Frankfurter approach.[15] Their test of a proper exception to state immunity was whether the States were enlarging their activities in ways, which, if immune, would withdraw traditional sources of federal revenue.

Justices Douglas and Black (326 U.S. at 590), as the Court said in *National League of Cities* v. *Usery*, 426 U.S. 833, 843, fn. 13 (1976), "advocated a position even more protective of state sovereignty." They made a point of referring to the issuance of securities as protected by the immunity rule. 326 U.S. at 591, 593.

National League of Cities v. *Usery*, 426 U.S. 833, 843 (1976), while not a tax case, was based in part on the four-Justice opinion in *New York* v. *United States* and on the statement in the tax case of *Metcalf & Eddy* v. *Mitchell*, 269 U.S. 514, 523 (1926) that "neither government may destroy the other nor curtail in any substantial manner the exercise of its powers."

On its face the registration requirement of IRC §103(j) offends this updated test; it would curtail in substantial manner the exercise of the State's power to determine the optimal form of its bonds.

In arguing on the Court's questions in *New York* v. *United States*, the state attorneys general, as *amici*, argued

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[15] 326 U.S. at 586. The unusual sequence of the opinions in *New York* v. *United States* was noted in *National League of Cities* v. *Usery*, 426 U.S. 833, 843, fn. 13 (1976).

from hypothetical examples that the power to tax state activities would necessarily bring on federal control of the States by exemptions, conditions and qualifications. (Br. p. 20). Our examples need no longer be hypothetical. Control by taxation of municipal bond interest exists in and under portions of IRC §103, itself.

In February, 1983, the IRS ruled that bonds of the City of Atlanta issued to improve runways at its public airport and satisfying all Georgia state law requirements for valid issuance by Atlanta will be taxable unless, in addition, a second municipality in which the runway is located also approved the bonds under IRC §103(k).[16]

The distribution of a State's powers as between its political subdivisions is clearly reserved exclusively to the States by the Tenth Amendment. Yet Congress asserts it under the taxing power.

The veto thus given by Congress to some municipalities over certain authorized activities of other municipalities arises by reason of the definition in IRC §103(b)(2) of "industrial development bonds" to which IRC §103(k) applies. The definition includes not only bonds for private industrial development but also bonds to finance any public facility for public purposes if the facility is to have non-exempt users[17] to an extent exceeding 25% and if the bonds are to be paid to an extent exceeding 25% from payments by such users.[18] Congress thus arbitrarily tagged as "industrial development bonds", bonds to finance public airports, public piers, public parking facilities, local public water works, and any other public facility failing the two 25% tests.

Because airports were listed among the "exempt activities" in §103(b)(4)(D), the original tax did not apply to

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[16] Private Letter Ruling 83-1905 dated February 7, 1983.

[17] Non-exempt users include the United States, foreign governments and private persons not listed as exempt under IRC §501 (c)(3). See IRC §103 (b)(3); 26 CFR §1.103(7)(b)(2).

[18] IRC §103 (b)(2) uses the term "major portion" to describe the proscribed quantity of private use or payments. Treasury regulations have quantified "major portion" as anything over 25% 26 CFR §1.103(7)(b)(3)(iii).

airport bonds.[19] But the Tax Equity and Fiscal Responsibility Act of 1982 enacted not only IRC §103(j) but also IRC §103(k) which requires "public approval" in a specified way for *all* "industrial development bonds", including public airport bonds, as well as any other public facility bonds caught up in the definition. Such "public approval" is required not only by the public issuer but by any other political subdivision in which the financed facility is located. (IRC §103(k)(1))

Atlanta's public airport, like those of many other cities,[20] is located outside its municipal boundaries. Having determined that over 25% of the use of a runway improvement to be financed with new Atlanta bonds would be by two airlines, the Treasury ruled in February, 1983 that the bonds would be "industrial development bonds" and would be taxable unless the other municipality approved, and this although Georgia state law gives no such veto to the second municipality.

Congress, in other words, having asserted the power to tax a class of bonds has used it to strip a legislative power from one subdivision of a State and bestow it on another.

Furthermore in IRC §103(k)(2)(B) Congress has prescribed the kind of "public approval" without which such public facility bonds are to be taxed. If the bonds are within the expansive "industrial development bond" definition then they are taxed unless they are approved by an "elected representative" or by "voter referendum". And this is so even if the state constitution or statutes provide that the bonds may be issued without such approvals.

Should not the mechanism for approving state or local government bond issues be exclusively a state function under the Tenth Amendment?

If the answer is that Congress has not required approval of bonds in a way contrary to state law but merely denied tax-exemption to bonds not meeting federal requirements,

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[19] Except, under a provision which is now IRC §103(b)(13), for any period during which the bonds may be held by a "substantial user" of the financed facility.

[20] E.g. San Francisco, Chicago, Cincinnati.

then that answer makes our point. The power to tax is indeed the power to control and regulate the most detailed internal affairs of the States. It truly is the power to destroy state sovereignty.

Under Treasury regulations now in force under IRC §103(c), exemption is forfeited for some refunding bonds of state and local governments *unless the proceeds are loaned to the United States.*[21] What is more, the formula for establishing the interest rate to be paid by the United States translates into a rate below the going market rate payable at the time by the United States to other investors for obligations of the same maturity.[22]

Can anyone doubt that if Congress and the Treasury ever achieved the constitutional power to tax any and all state and local government bonds, they would use it to displace state policy across the board? We could have federal lists of the only permitted purposes for all borrowing as we now have for "industrial development bonds" under IRC §103(b)(4). We could have federal requirements for referenda, multiple municipal approval, and other details of the approval process at the local level, as we now have in IRC §103(k). We could have dollar volume limits on each State, as we now have for "mortgage subsidy bonds" under IRC §103A.

Without the immunity of state and municipal borrowing, the National Government could displace the policies of the States in the governance of local affairs; the balance be-

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[21] This is the combined effect of 26 CFR 1.103-13(b)(5)(iii), 1.103-13(c)(1)(iii) and 1.103-14(e).

[22] The rate must not exceed the yield on the state or local government bond issue except by an infinitesimal amount (26 CFR 1.103(b)(5)(iii)). *Normal* federal bond yields are substantially higher (because they are taxable) than yields on high quality municipal bonds of comparable maturity. See chart, New York Times, September 26, 1983, p. D10.

The Treasury has established a special issue of United States obligations "available" to the States and local governments, and to no one else, to permit them to invest the affected bond proceeds at a low enough rate to permit the escape from unpermitted "arbitrage" (31 CFR Part 344). The volume of such forced loans now outstanding is many billions of dollars.

tween the National Government and the States would be gone.

POINT III

The history of the Sixteenth Amendment shows an intention to deny the National Government power to tax state and local government bond interest.

In a challenge to the 1894 income tax act the first decision in *Pollock* v. *Farmers' Loan & Trust Company,* 157 U.S. 429 (1895), distinguished four kinds of income covered by the act: (1) salaries, professional income and business profits; (2) real estate rentals and profits; (3) income and profits from private personal property, including stock dividends and bond and note interest; and (4) interest from state and municipal bonds. The Court held unanimously that an income tax on income from the source of salaries, professional income and business profit was an indirect tax and within Congress' power without apportionment. 157 U.S. at 578. As to real estate, the Court held 7-2 that a tax on income from that source was a direct tax and that the 1894 act was unconstitutional with regard to it for lack of apportionment. As to the tax on income from the source of personal property, the Court was evenly divided as to whether it was direct so as to require apportionment. As to municipal bond interest, *all* of the Justices agreed that there was a total lack of power, not curable by apportionment, 157 U.S. at 585, 601, 652, 653.

The even division on the personal property question required, occasioned a rehearing and the second *Pollock* decision. 158 U.S. 601 (1895). The result was 5-4 against the constitutionality of an unapportioned income tax on income from the source of personal property as well as real estate (158 U.S. at 637), but a unanimous reaffirmation that income from state and municipal bond interest was totally immune, whether or not the tax was apportioned. See *Hale* v. *State Board,* 302 U.S. 95, 107 (1937). Finally, the entire act was struck down.

On April 27, 1909, Senator Brown introduced a resolution to amend the Constitution to provide "The Congress

shall have the power to lay and collect taxes on income and inheritances." (44 Cong. Rec. 1548). This formulation was criticized because Congress already had that power. Senator Raynor said: "unless you change the clause of the Constitution which provides for apportionment, the joint resolution will not repeal that clause." (44 Cong. Rec. 1568-1569).

On June 16, 1909, President Taft recommended that the Congress "shall propose an amendment to the Constitution conferring the power to levy an income tax upon the national government without apportionment among the states in proportion to population." (44 Cong. Rec. 3344).

Senator Brown responded the next day with the introduction of another joint resolution (44 Cong. Rec. 3377).

> "The Congress shall have power to lay and collect direct taxes on income without apportionment among the several states according to population."

On June 28, 1909, the Senate Finance Committee brought in a joint resolution in the language of the present Sixteenth Amendment. The word "direct" was removed from the Brown formulation and the words, "from whatever source derived," were substituted, with no explanation of the change. (44 Cong. Rec. 3900). It was, however, a more precise formulation because the *Pollock* apportionment requirement, which was to be overcome, related to a distinction between the various sources of income.

No suggestion was ever made in Congress that the proposed Amendment had anything to do with taxation of state and local government bond interest.

The proposed Amendment then went to the States for ratification and was proceeding at a reasonable pace until Governor Charles E. Hughes' famous message to the New York States Legislature on January 5, 1910.[21] He raised the possibility that "The comprehensive words, 'from whatever source derived', if taken in their natural sense, would include not only incomes from ordinary real or personal

[21] Public papers of Governor Hughes, pp. 71, 73.

property, but also incomes derived from State and municipal securities," a result which he opposed.

The sponsors of the amendment reacted sharply. As Senator Borah, a leading supporter of the Amendment, said on February 10, 1910, the Hughes message could derail the ratification process. He therefore made a lengthy legal argument contesting the Hughes position. (45 Cong. Rec. 1694 et seq.).

On February 23, 1910, Senator Brown, the original introducer of the Amendment Resolution, spoke to the Senate to the same effect. (45 Cong. Rec. 2245, 2247).

Senator Root of New York wrote to a member of the New York Legislature to counter the deterrent effect of his Governor's message. He said of the Hughes objection:

> "I do not find in the Amendment any such meaning or effect."

The Root letter was widely publicized. *The New York World* said in an editorial on March 1, 1910 (p. 10):

> "Mr. Root proves that the Amendment does not open a way for the taxation of State securities. He shows that the words from whatever source derived are solely designed to meet the situation raised in the decision of 1895 which distinguished between income from personal property and income derived from business or occupation." [24]

This Court held in 1916, when its members were contemporaries familiar with the debates on the subject and included former Governor Hughes himself, that the Amendment added no new subject to the taxing power of Congress, but merely eliminated the apportionment requirement. *Brushaber* v. *Union Pacific R. Co.*, 240 U.S. 1, 11 (1916); *Stanton* v. *Baltic Mining Co.*, 240 U.S. 103, 112 (1916).

Peck & Co. v. *Lowe*, 247 U.S. 165, 172 (1918) the Court reviewed the history of the Hughes message and the Senators' responses and reached the same result.

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[24] In 1918, Rep. Thomas, in the House of Representatives, said of the Root letter: "Upon the strength and under the interpretation outlined in this letter, the General Assemblies of the States of New York and New Jersey finally ratified the amendment." (56 Cong. Rec. 10631)

In *Willcutts* v. *Bunn*, 282 U.S. 216, 226 (1931), Chief Justice Hughes discarded his earlier concern saying for a unanimous Court:

> "In the case of the obligations of a state or of its political subdivisions, the subject held to be exempt from Federal taxation is the principal and interest of the obligations. *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U.S. 429, 584-586 * * *."

Of all the arguments against the immunity of state bond interest, none is more specious than that it was ended by the Sixteenth Amendment. Rather we submit the contrary: reconsideration of the bond interest immunity rule was foreclosed by the ratification of the Amendment in reliance on assurances by its sponsors that the immunity would survive its adoption.

If Congress has the power to tax the interest on unregistered bonds under IRC §103(j) it cannot be because it has the power to tax the interest on all bonds of the States under the Constitution. It is open to the defendant only to argue that unregistered bonds are within some exception to the basic rule of bond immunity under the Constitution—an exception for which we find no basis.

Wherefore, *Amici* respectfully urge that the relief sought by plaintiff be granted.

Respectfully submitted,

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September 1983

No. 94, Original

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

STATE OF SOUTH CAROLINA,
Plaintiff,
v.
DONALD T. REGAN, SECRETARY OF THE TREASURY OF THE UNITED STATES OF AMERICA,
Defendant.

On Motion for Leave to File Complaint

MOTION OF THE NATIONAL ASSOCIATION OF COUNTIES, THE NATIONAL CONFERENCE OF STATE LEGISLATURES, THE U.S. CONFERENCE OF MAYORS, THE COUNCIL OF STATE GOVERNMENTS, THE MUNICIPAL FINANCE OFFICERS ASSOCIATION, BILL GUNTER, TREASURER OF THE STATE OF FLORIDA, EDWARD V. REGAN, NEW YORK STATE COMPTROLLER AND THE STATE OF WEST VIRGINIA FOR LEAVE TO FILE A BRIEF AS AMICI CURIAE IN SUPPORT OF SOUTH CAROLINA'S MOTION FOR LEAVE TO FILE AN ORIGINAL COMPLAINT AND BRIEF AS AMICI CURIAE IN SUPPORT THEREOF

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QUESTION PRESENTED

Whether this Court should exercise original jurisdiction to determine if the federal government can constitutionally impose a tax on interest income from state and local general obligation bonds, when such tax will gravely impair the ability of state and local governments to perform essential sovereign functions and to fulfill their role in the Union.

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Pursuant to Rule 9.6 of the Rules of the Court, the *amici curiae* seek leave to file the attached *amicus* brief in support of South Carolina's Motion for Leave to File an Original Complaint.

The *amici* include organizations which represent state and local governments or their officials located throughout the United States; financial officials of state governments; and the State of West Virginia. The governments represented by or associated with the amici organizations and officials, and the State of West Virginia, collectively issue billions of dollars of general obligation bonds every year. A major question presented in South Carolina's action is whether the federal government may constitutionally impose a tax on the interest paid on such bonds. *Amici* have a critical interest in this constitutional question because the imposition of a tax on general obligation bonds will gravely impair the ability of state and local governments throughout the nation to function effectively in a federal system and to carry out essential sovereign functions.

Amici seek to assist the Court in resolution of the constitutional question by addressing crucial points that have been largely unattended by the parties. *Amici's* brief discusses the serious consequences that will be suffered by state and local governments if interest on state and local general obligation bonds is taxed. Such consequences will result from a dramatic rise in the interest rates paid by state and local governments and the concomitant impairment of their ability to perform their sovereign responsibilities.

Amici's brief also discusses the impact of the Sixteenth Amendment upon the historically established tax immunity of state and local general obligation bonds. It is *amici's* submission that, as shown by its legislative history and subsequent interpretations of this Court, the Sixteenth Amendment did not alter but instead specifically preserved the constitutional tax immunity enjoyed by interest on state and local bonds.

Finally, *amici's* brief also discusses a new jurisdictional hurdle first asserted by the Defendant in his Supple-

mental brief. *Amici* demonstrate that this new hurdle is constitutionally flawed.

The defendant and the State of South Carolina, by letters dated August 29, 1983 and September 16, 1983, respectively have consented to the filing of the attached *amicus* brief.* Such filing will not delay the hearing in this case, but will, we believe, assist the Court in assessing crucially important issues.

CONCLUSION

For the foregoing reasons, this Court should grant leave to file the attached brief *amicus curiae.*

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* The letters of consent have been lodged with the Clerk of the Court.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

No. 94, Original

STATE OF SOUTH CAROLINA,
Plaintiff,

v.

DONALD T. REGAN, SECRETARY OF THE TREASURY OF THE UNITED STATES OF AMERICA,
Defendant.

On Motion for Leave to File Complaint

BRIEF OF THE NATIONAL ASSOCIATION OF COUNTIES, THE NATIONAL CONFERENCE OF STATE LEGISLATURES, THE U.S. CONFERENCE OF MAYORS, THE COUNCIL OF STATE GOVERNMENTS, THE MUNICIPAL FINANCE OFFICERS ASSOCIATION, BILL GUNTER, TREASURER OF THE STATE OF FLORIDA, EDWARD V. REGAN, NEW YORK STATE COMPTROLLER AND THE STATE OF WEST VIRGINIA AS AMICI CURIAE IN SUPPORT OF SOUTH CAROLINA'S MOTION FOR LEAVE TO FILE AN ORIGINAL COMPLAINT

INTRODUCTION

In this action a federal statute requires state and local bonds to be registered and imposes a penalty for non-registration. The penalty is loss of the tax exemption for interest on state and local obligations.

The requirement of registration and the penalty of loss of exemption are being imposed upon the general obligation bonds of the State of South Carolina. In South Carolina and elsewhere, general obligation bonds are used to finance essential sovereign activities such as construction of schools, roads, city halls, fire stations, police stations, prisons, water works, sewer systems and other vital facilities.

Amici take no position upon and do not discuss the federally imposed registration requirement. But *amici* do vigorously assail the penalty of forfeiture of tax exemption. *Amici* submit that this penalty is unlawful because interest on general obligation bonds of state and local governments is constitutionally exempt from federal income taxation. It is *amici's* further submission that the federal government's effort to remove this exemption raises a profound threat to the viability of state and local governments—a threat which is greater because attempts have been made to affect the historical exemption for state and local bonds in other contexts [1] and federal officials have made known their desire for a complete abolition of the exemption.[2]

INTEREST OF THE AMICI

Amici include organizations which represent state and local governments or their officials located throughout the United States, financial officials of state governments, and the State of West Virginia. The governments repre-

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[1] See, e.g., Social Security Amendments of 1983, Pub. L. No. 98-21, § 121, 97 Stat. 65. The Constitutionality of the other statutes affecting this historical exemption has not been examined by this Court.

[2] As noted by Arthur Abba Goldberg, "The CBO [Congressional Budget Office] and the Treasury generally agree on doing away with tax-exempt bonds." Goldberg, A Call to Action: State Sovereignty, Deregulation and the World of Municipal Bonds, 13 The Urban Lawyer 253, 269, n.47 (1981).

sented by and associated with the *amici* organizations and officials, and the State of West Virginia, collectively issue many billions of dollars of general obligation bonds every year. A major issue in this case is whether the federal government may constitutionally impose a tax on the interest paid on such bonds. *Amici* have a critical interest in this constitutional question because the imposition of a tax on general obligation bonds will gravely impair the ability of state and local governments throughout the nation to function effectively in a federal system and to carry out essential sovereign functions. Due to their vital interest in the constitutional issue, *amici* are submitting this brief to assist the Court in its resolution of this action.

SUMMARY OF ARGUMENT

1. The Tenth Amendment prohibits actions of the federal government which impair the ability of state and local governments to fulfill their role in the Union. Because of the need to protect the functioning of these governments, a law violates the Tenth Amendment if a generalized inquiry shows it will have obvious harmful effects on vital state and local activities.

The Amendment is thus violated by a federal tax on the interest on state and local general obligations bonds. These bonds are used to finance essential sovereign functions such as construction of schools, roads, police stations, fire stations, water works, waste disposal systems and other vital facilities. If general obligation bonds were not immune from taxation, the interest costs paid by state and local governments would rise dramatically and many of these governments might thereby be foreclosed from raising the money necessary to build essential facilities. Also, because of the large increase in their interest costs, state and local governments would have much less money remaining to pay for other sovereign functions. A serious threat to the viability of state and local governments

thus emanates from the federal government's claim it may tax the interest on general obligation bonds.

2. The constitutional prohibition against taxation of general obligation bonds was confirmed by the events surrounding the enactment of the Sixteenth Amendment. This is shown by the legislative history surrounding adoption of the Amendment and by decisions of this Court following enactment of the Amendment.

In the nineteenth century this Court, in recognition of the fundamental concept of dual sovereignty, established the doctrine of reciprocal immunity. Under this doctrine the federal and state governments could not tax the interest on each other's bonds. Despite this doctrine, in 1894 Congress enacted a law which taxed interest on state and local bonds.

In 1895 this Court declared the law unconstitutional. The Court ruled the tax on interest from bonds was invalid under the doctrine of reciprocal immunity. Also, it ruled that taxes on income from real and personal property were invalid because they were direct taxes on real estate and personal property, but were not apportioned among the states according to population as required by Article I, Section 2.

The Sixteenth Amendment was thereafter enacted to facilitate the taxation of income on real and personal property by eliminating the requirement that a tax on such income must be apportioned by population. However, the amendment was not intended to affect the doctrine of reciprocal immunity, under which the interest from state and local bonds was exempt from taxation. Rather, the constitutional immunity of such interest was preserved. This was specifically recognized by decisions of this Court following enactment of the amendment.

3. Although the tax immunity for interest on general obligation bonds is protected by the Constitution, the Secretary appears to assert the legality of such taxes by

claiming that the federal government can levy certain other allegedly analogous taxes. The Secretary's alleged analogies are misplaced. The other taxes present different problems and considerations. Also, the constitutionality of several allegedly analogous taxes has not been determined by this Court.

4. This Court has original jurisdiction of South Carolina's claim. Under the factors governing the discretionary exercise of such jurisdiction, the Court should entertain this action.

In applying its discretion the Court considers the policies underlying the Article III jurisdictional grant, and the Court's other judicial responsibilities. It assesses, among other things, the seriousness and dignity of the claim; the availability of another adequate forum; and its responsibilities to the national system. These factors are clearly met here because the state is asserting a well founded constitutional claim relating to fundamental concepts governing the role of the federal and state governments. The policies underlying Article III jurisdiction, and the Court's judicial responsibilities, clearly encompass consideration of such a claim.

The Secretary argues that this Court's jurisdiction is barred by federal statutes, and that the Court should decline jurisdiction as a matter of discretion. This argument should be rejected because the Constitution specifically empowers the Court to hear the action and all discretionary factors are met here.

ARGUMENT

I. It is Unconstitutional For The Federal Government to Tax The Interest On State and Local Bonds, And The Question Whether this Court should Exercise Original Jurisdiction Is Significantly Dependent Upon this Substantive Constitutional Issue

This action requires the Court to consider whether it should exercise original jurisdiction and whether the federal government may constitutionally impose a tax on interest from general obligation bonds issued by state and local governments. The jurisdictional question inextricably implicates the substantive constitutional issue. For in determining whether to exercise its original jurisdiction, the Court considers, among other things, "the seriousness and dignity of the claim," *Illinois* v. *City of Milwaukee*, 406 U.S. 91, 93 (1972), whether the exercise of jurisdiction will serve the policies underlying the grant of original jurisdiction, and whether the exercise of jurisdiction will serve the Court's "paramount responsibilities to the national system", *Ohio* v. *Wyandotte Chemicals Corp.*, 401 U.S. 493, 497, 499 (1971). These matters bearing on original jurisdiction necessitate prior understanding of the substantive constitutional issue. Therefore *amici's* discussion of the merits precedes a discussion of the factors bearing on the exercise of original jurisdiction.

A. Established Tenth Amendment Precepts Are Violated By The Federal Government's Claim that it can Tax The Interest On General Obligation Bonds Of State and Local Governments

This Court has repeatedly made clear that the Tenth Amendment prohibits federal regulation which "hamper[s] [a] state government's ability to fulfill its role in the Union" and thereby "undermine[s] the role of the States in our federal system." *United Transportation Union* v. *Long Island R.R.*, 455 U.S. 678, 688 (1982). The Court has thereby "recogniz[ed] the essential role of

the States in our federal system of government," *National League of Cities* v. *Usery*, 425 U.S. 833, 844 (1975). This role must be protected because "the Constitution, in all its provisions, looks to an indestructible Union, composed of indestructible States," *National League of Cities* at 844, quoting *Texas* v. *White*, 74 U.S. (7 Wall.) 700, 725 (1869).

Because of the need to protect the functioning of state and local governments, the constitutionality of federal laws having an adverse financial effect upon these entities "does not depend, . . . on 'particularized assessment of actual impact,' which may vary from State to State and time to time, but on a more generalized inquiry, essentially legal rather than factual, into the direct and obvious effect of the federal legislation on the ability of the states to allocate their resources." *EEOC* v. *Wyoming*, 103 S. Ct. 1054, 1063 (1983). Thus, in assessing constitutionality it is sufficient that "enough [effects of a federal law] can be satisfactorily anticipated for an outline discussion of their general import." *National League of Cities* at 850. A federal statute is therefore unconstitutional when it will have obvious adverse effects upon vital state and local activities such as schools, public health, sanitation, parks and recreation, fire prevention and police protection. *National League of Cities* at 851.

These established constitutional precepts are violated by the federal government's claim that it can tax the interest on general obligation bonds of state and local authorities. General obligation bonds, which have been issued since the nation began, are used to finance the most vital sovereign functions of state and local governments all across the country. They finance the construction of schools, roads, city halls, fire stations, police stations, prisons, hospitals, water works, sewer systems, and solid waste disposal facilities. If these bonds were not immune from federal taxation, the interest costs paid by state and local governments would rise dramatically and many of

these governments might thereby be foreclosed from raising the money necessary to build essential sovereign facilities. Also, because of the large increase in their interest costs, state and local governments would have less money remaining to pay for other sovereign functions. These other functions would suffer accordingly.

The harmful consequences that would result if state and local bonds, including general obligation bonds, were subjected to taxation have been set forth in affidavits of officials of leading financial houses, including Morgan Guaranty Trust Company and Goldman, Sachs & Co., which are major participants in the state and local bond markets.[3] The affidavits state that, in the absence of an exemption, many localities could be precluded from raising monies for projects, and they variously estimate that the interest rates on state and local bonds would rise between 25 and 75 percent.[4] Thus, if a state or local government pays 10 percent annual interest on a tax-exempt bond, it would have to pay between 12.5 percent and 17.5 percent if the exemption were unavailable. On a one hundred million dollar, 20-year issue the increased interest would run between 2.5 and 7.5 million dollars per year, or from 50 to 150 million dollars over the life of the bond.

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[3] See the Affidavits of Richard L. Tauber, Vice President, Public Finance Department, Morgan Guaranty Trust Company, dated September 13, 1983; Terrence E. Comerford, Managing Director of Blyth Eastman Paine Webber Incorporated, dated September 7, 1983; Charles M. Harmon, Jr., General Partner, Goldman, Sachs & Co., New York, dated September 8, 1983; C. W. Houser, Senior Vice President, First City National Bank, Austin, Texas, dated September 2, 1983; James H. Kerley, Jr., Executive Vice President, First Southwest Company, Dallas, Texas, dated September 6, 1983; John E. Peterson, Director, Government Finance Research Center, Municipal Finance Officers Association, Washington, D.C., dated September 20, 1983; printed in the Appendix to this brief.

[4] One affidavit even estimates that in some circumstances the interest rate could rise between 200 and 300 percent. Affidavit of Charles M. Harmon, Jr., printed in Appendix to this brief.

Moreover, the collective amount of increased interest paid by all state and local governments would be staggering. Richard L. Tauber of Morgan Guaranty Trust Co. has stated that over 78 billion dollars of long term municipal bonds were issued in 1982 alone.[5] Thus, if one assumes a 10 percent interest rate on tax-exempt bonds,[6] and estimates that interest costs would increase from 25 to 75 percent in the absence of exemption, the increase in collective annual interest costs would run from 525 million dollars per year to 1.575 billion dollars per year. Extended over 10 years of annual interest payments, the increase in interest costs would range between 5.25 billion dollars and 15.75 billion dollars.

It is thus clear that a serious threat to the viability of state and local governments emanates from the federal government's claim that it can tax the interest on state and local general obligation bonds. As this Court has stated, constitutional analysis does not require precision in assessing the exact magnitude of the threat. Rather, it is enough that we can plainly anticipate obvious adverse effects upon sovereign functions. *National League of Cities* at 851. Here, such effects are the only anticipatable results of the federal claim of taxability. On its face, therefore, the federal claim violates the Tenth Amendment, which protects state and local authorities against federal impairment of their role in the Union.

B. The Sixteenth Amendment Preserved The Historically Tax Exempt Character of State and Local Bonds

The historically established constitutional exemption for interest on state and local bonds was preserved by the Sixteenth Amendment. This is demonstrated by exami-

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[5] General obligation bonds constituted approximately 21 billion dollars of this total. Affidavit of John E. Peterson, printed in Appendix to this brief.

[6] The average yield of "A rated" municipal bonds issued in today's market is 9.75%. Affidavit of James H. Kerley, Jr., printed in Appendix to this brief.

nation of the legislative history surrounding adoption of the amendment and the views of this Court expressed in years following enactment of the amendment.

In the nineteenth century this Court established the doctrine of reciprocal immunity. *McCulloch* v. *Maryland*, 17 U.S. (4 Wheat) 316 (1819); *Weston* v. *City of Charleston*, 27 U.S. (2 Pet.) 449 (1829); *The Collector* v. *Day*, 78 U.S. (11 Wall) 113 (1871); *Pollock* v. *Farmers Loan and Trust Co.*, 157 U.S. 419 (1895), opinion on rehearing, 158 U.S. 601 (1895). Under this doctrine, states could not tax the interest on federal bonds and the federal government could not tax the interest on state bonds. The doctrine recognized and protected the unique American system of dual sovereignties. As stated in *Collector* v. *Day*, at 124-127:

> The general government, and the states, although both exist within the same territorial limits, are separate and distinct sovereignties, acting separately and independently of each other, within their respective spheres.
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> * * * *
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> Such being the separate and independent condition of the states in our complex system . . . it would seem to follow, as a reasonable, if not a necessary consequence, that the means and instrumentalities employed for carrying on the operations of their governments for preserving their existence, and fulfilling the high and responsible duties assigned to them in the Constitution, should be left free and unimpaired; should not be liable to be crippled, much less defeated by the taxing power of another government . . . .

Despite the doctrine of reciprocal immunity, in 1894 the federal government enacted a statute which taxed the interest on state and local bonds. It also taxed income from real estate and personal property.[7] The constitu-

[7] A tax was levied as well on other forms of income, such as salaries and interest on corporate bonds.

tionality of this statute was at issue in this Court's two 1895 decisions in *Pollock*, *supra*.

In its first *Pollock* decision, the Court held that the tax on income from real estate was unconstitutional because it was a direct tax on real property but was not apportioned among the states according to the size of their populations. It thus violated Article I, Section 2, which specifically directed that "direct taxes shall be apportioned among the several states . . . according to their respective numbers." The Court also held the tax on interest from state and local bonds unconstitutional under the doctrine of reciprocal immunity because the tax was levied on the instrumentalities of state and local governments.[8]

On rehearing the Court adhered to its decision that the tax on income from real estate was void, and extended that holding to the tax on income from personal property, saying the levy was a direct tax on personal property but was not apportioned by population. The Court adhered to its holding that the tax on interest from state and municipal bonds was unconstitutional because it was a levy on the instrumentalities of state and local governments.

Subsequent to the *Pollock* case, Congress approved and the states ratified the Sixteenth Amendment. The amend-

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[8] Justice Fuller, writing for the Court, said a tax on the interest on state bonds "would operate on the power to borrow before it is exercised, and would have an impermissible influence on the contract." He further said the levy would be a "tax on the power of the states and their instrumentalities to borrow money and consequently repugnant to the Constitution." 157 U.S. at 586. And in a separate opinion accompanying both majority opinions, Justice Field stated that "[t]hese bonds and securities are as important to the performance of the duties of the State as like bonds and securities of the United States are important to the performance of their duties, and are as exempt from the taxation of the United States as the former are exempt from the taxation of the states." 157 U.S. at 601.

ment was designed to facilitate the taxation of income from real and personal property by eliminating the *Pollock* requirement that a tax on income from such property must be apportioned by population. Elihu Root of New York, a leading Senatorial proponent of the amendment, specifically pointed out that its purpose was to permit taxation of income from real and personal property:

> The proposal followed the suggestion of the Supreme Court in the *Pollock case*. The evil to be remedied was avowedly and manifestly the incapacity of the National Government resulting from the decision that income practically could not be taxed when derived either from real estate or from personal property, although it could be taxed when derived from business or occupation.

45 Cong. Rec. 2539-40 (1910).

The amendment, however, was not intended to affect the long established doctrine of reciprocal immunity under which interest on state and local bonds was constitutionally exempt from taxation. Rather, the constitutional exemption for such interest was specifically preserved. This was made express in response to an objection raised by Governor Hughes of New York when submitting the amendment to his state legislature for ratification.

In his message to the state legislature, Governor Hughes pointed to the language of the amendment, which states that "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration." Governor Hughes called attention to the phrase "from whatever source derived," suggested that phrase might permit taxation of interest on state and local obligations, and objected to the amendment on this basis. Special Message from the Governor, New York Senate, No. 3 (1910).

Governor Hughes' suggestion, made on January 5, 1910, received national attention.[9] It was soon replied to and rejected by three leading Senators who championed the Amendment, Senator Borah of Idaho, Senator Root of New York, and Senator Brown of Nebraska, who had steered the amendment through Congress.

On February 10, 1910, Senator Borah indicated that Governor Hughes' suggestion was incorrect because the taxing power of the federal government was subject to implied limitations, 45 Cong. Reg. 1694-99. On February 17, 1910, Senator Root said that "much as I respect the opinion of the Governor of the State, I cannot agree with the view expressed in his special message on January 5." 45 Cong. Rec. 2539 (1910). Speaking as one who had "advocated in the Senate . . . the proposed amendment," Senator Root then gave "[his] view of its effect." That view, quoted *supra*, was that the amendment was simply intended to allow taxation of income from real and personal property.

On February 23, 1910, Senator Brown likewise repudiated Governor Hughes' suggestion. Senator Brown said:

> The amendment does not alter or modify the relation today existing between the States and the federal government. That relation will remain the same under the amendment as it is today without the amendment. It is conceded by all that the Government cannot, under the present constitution, tax state securities or state instrumentalities . . .

45 Cong. Rec. 2245-46 (1910).

The views of leading proponents of the Amendment thus demonstrate that it did not alter but instead pre-

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[9] See Editorial, Wall Street Journal, January 6, 1910, p. 2; Chicago Daily Tribune, January 7, 1910, p. 8; Dover Republican, January 12, 1910, p. 6; World-Herald (Omaha), January 10, 1910, p. 4 (Editorial); New York Times, March 2, 1910, p. 8.

served the historical immunity from taxation of interest on state and local bonds. This construction is confirmed by numerous decisions of this Court issued within 25 years of the enactment of the Amendment.

This Court repeatedly held that the Sixteenth Amendment "did not extend the taxing power to new subjects, but merely removed the necessity which might otherwise exist for an apportionment among the States of taxes laid on income". *Eisner* v. *Macomber*, 252 U.S. 189, 206 (1920).[10] The Court further stated that "a tax on the interest payable on state and municipal bonds has been held invalid as a tax bearing directly upon the exercise of the borrowing power of the Government". *Helvering* v. *Mountain Producers Corporation*, 303 U.S. 376, 386 (1938). In the latter regard, Chief Justice Stone pointed out for the Court that a federal tax on the interest would "threaten impairment of the borrowing power of the state." *Helvering* v. *Gerhardt*, 304 U.S. 405, 466 (1938).[11]

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[10] See also, *Brushaber* v. *Union Pacific R.R. Co.*, 240 U.S. 1, 17-19 (1916); *Stanton* v. *Baltic Mining Co.*, 240 U.S. 103, 112 (1916); *Tyee Realty Co.* v. *Anderson*, 240 U.S. 115, 117-118 (1916). *William E. Peck & Co.* v. *Lowe*, 247 U.S. 165, 172-3 (1918); *Evans* v. *Gore*, 253 U.S. 245, 255 (1920); *Metcalf* v. *Mitchell*, 269 U.S. 514, 521-522 (1926); *National Life Ins. Co.* v. *United States*, 277 U.S. 508, 521 (1928); *Willcuts* v. *Bunn*, 282 U.S. 216, 225-226 (1931); *Indian Motorcycle Co.* v. *United States*, 283 U.S. 570, 577 (1931); *Trinity Farm Construction Co.* v. *Grosjean*, 291 U.S. 466, 471 (1934); *Ashton* v. *Cameron County Water W.I., District No. One*, 298 U.S. 513, 530 (1936); *James* v. *Dravo Contracting Co.*, 302 U.S. 134, 156 (1937); *Hale* v. *Iowa State Board*, 302 U.S. 95, 107 (1937).

[11] It is noteworthy that Chief Justice Hughes, who as Governor of New York expressed concerns that the Sixteenth Amendment could be read to authorize federal taxation of the interest on state and local bonds, authored several opinions pointing out that interest on these bonds was immune from taxation and that the Sixteenth Amendment did not extend the federal taxing power to new subjects. *Willcuts, id.*; *Mountain Producers, id.*; *Dravo Contracting Co., id.*

C. The Federal Government Has Presented Faulty Analogies To Support Its Claim That It Can Tax Interest On General Obligation Bonds

Foregoing sections of this brief demonstrate that the tax exempt character of state and local general obligation bonds is constitutionally protected by the Tenth Amendment and that the historical tax immunity of the bonds was reaffirmed by enactment of the Sixteenth Amendment. However, the Secretary appears to briefly argue, by way of analogy, that the taxation of bond interest is constitutional because the federal government is presently taxing the incomes and benefits of state employees, capital gains on the sale of municipal bonds or transfers of such bonds occurring because of gift or death, and industrial development or arbitrage bonds.[12] These analogies are misplaced and will not support a tax on general obligation bond interest.

Several of the allegedly analogous taxes do not pose the same threat to the viability of state and local governments as does a tax on bond interest. This is true, for example, of capital gains taxes, gift and estate taxes, and taxes on the incomes of state employees. Because these taxes do not threaten to impair or undermine the ability of state and local governments to perform their role in the Union,[13] they do not raise the same Tenth Amendment problems as a tax on interest from general obligation bonds.

As well, unlike a tax on interest on bonds, the allegedly analogous taxes such as those on capital gains, industrial revenue bonds, and arbitrage bonds were not the subject of pinpoint Sixteenth Amendment legislative history showing that the taxes are unconstitutional.

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[12] Brief for the Defendant In Opposition at 7, 7 n.8, 10-11.

[13] When holding that a tax could be imposed on the salaries of state employees, this Court specifically distinguished a tax on interest because it "threaten[s] impairment of the borrowing power of the state." *Helvering* v. *Gerhardt*, *supra*, at 466.

Finally, this Court has not determined the constitutionality of some of the claimed analogous taxes such as the tax on industrial revenue and arbitrage bonds. A tax on these types of bonds raises a number of considerations not presented by a tax on general obligation bonds. Since the constitutionality of the supposedly analogous taxes is undecided, and raises different considerations, it is an impermissible bootstrap to argue that these taxes support a tax on the interest on general obligation bonds.

II. This Court Should Exercise Its Original Jurisdiction

The complaint states a genuine case or controversy between South Carolina and a citizen of another state. Therefore, this Court has jurisdiction pursuant to Article II, Section 2, Clause 2 of the Constitution.[14]

Of course, this Court has not always exercised its original jurisdiction, even though it has observed that the founding fathers may have initially contemplated it would always do so. *Ohio* v. *Wyandotte Chemicals Corp.*, 401 U.S. 493 (1971). In determining whether to exercise its jurisdiction the Court considers the policies underlying the Article III jurisdictional grant, and its other judicial responsibilities, *Wyandotte Chemicals* at 499. The Court thus assesses: (1) "the seriousness and dignity of the claim," *Illinois* v. *City of Milwaukee*, at 93; (2) the availability of "another adequate forum in which [the plaintiff can] settle his claim," *United States* v. *Nevada*, 412 U.S. 534, 538 (1972); and (3) that "the Court's paramount responsibilities to the national system lie almost without exception in the domain of federal law," *Wyandotte Chemicals* at 497.

The application of these guideposts for determining jurisdiction counsel in favor of its exercise here. A sovereign state is raising a serious and well founded claim

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[14] The Secretary appears to concede the existence of jurisdiction in this Court. Brief for the Defendant in Opposition at 11; Supplemental Memorandum of Defendant at 1 and 1, n.1.

that the federal government has adopted an unconstitutional statute, and that the federal government's actions threaten to impair the ability of state and local governments to perform their constitutional roles. The State's claim is supported by the Tenth Amendment, by the legislative history surrounding ratification of the Sixteenth Amendment, and by decisions of this Court. The claim raises vital issues of federal law, not questions of local law. Such important issues of federal law are preeminently within this Court's paramount responsibilities to the national system, and resolution of them by the Court paradigmatically serves the policies underlying the jurisdictional grant.

Further, an alternative forum does not seem to be available here. For the parties agree, with apparent merit, that the Anti-Injunction Act and its counterpart in the Declaratory Judgment Act bar suit in the lower courts.[15] Thus, this Court is the only tribunal in which South Carolina may bring suit to enforce its constitutional rights.

In his two briefs, the Secretary seeks to elide the appropriateness of the exercise of original jurisdiction. In the initial brief it was argued that the Anti-Injunction Act, and its counterpart in the Declaratory Judgment Act, are an absolute bar to suit in this Court by South Carolina. Thus, it was argued in effect that the statutory provisions constitute a withdrawal of the constitutional jurisdiction of this Court.

Subsequently, in his second brief, the Secretary argued that the statutory provisions constitute a procedural rule which is "not a withdrawal of subject matter jurisdiction" but "merely a limitation of remedies and a restriction on timing." And in both briefs the Secretary has

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[15] Brief for the Defendant in Opposition at 4-11; Motion of South Carolina for Leave to File Complaint at 38-39; Reply Brief of Plaintiff at 3.

argued that, even if jurisdiction is not prohibited as a matter of binding statutory law, this Court nevertheless should decline to exercise it as a matter of discretion.[16]

No matter what form the Secretary's argument has taken at various times, however, its overriding defect is the same. It would bar the exercise of original jurisdiction by this Court even though such jurisdiction is specifically granted by the Constitution and the discretionary factors traditionally considered by the Court are met. The Secretary's argument thus contravenes Article III of the Constitution and the jurisprudence of this Court, and should therefore be rejected.[17]

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[16] In his first brief the Secretary also suggested the Court should decline to exercise jurisdiction because the case allegedly does not present matters of "urgent concern" and requires "evidence of the actual burden" upon South Carolina. Brief For The Defendant In Opposition at 12. However, as shown earlier in this brief, the case presents serious constitutional questions relating to the ability of states and local governments to function in the federal union, and resolution of these questions does not require "a particularized assessment of actual impact," but only a generalized assessment of the effects of the statute. *National League of Cities* at 851. The affidavits filed in this case fully demonstrate the adverse impact of the Secretary's position.

[17] The overriding flaw in the Secretary's argument is not cured by his assertions that nothing "prevents a State, as taxpayer" from invoking the jurisdiction of the Court, or that the State could "support" a third party taxpayer in a test case. South Carolina is not asserting rights as a taxpayer, but sovereign rights protected by the Constitution. Moreover it need not await or rely on a suit by a third party taxpayer in order to vindicate its own sovereign rights.

CONCLUSION

For the foregoing reasons, this Court should grant the Motion for Leave to File an Original Complaint.[17]

Respectfully submitted,

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Counsel for the Amici Curiae

[17] Of course, after granting leave to file, the Court may also determine the merits without further delay, and rule that a tax on general obligation bonds is unconstitutional. This disposition would be appropriate because the Constitution clearly prohibits such a tax, and no public purpose would be served by the expense and delay of further adjudication.

No. 94, Original

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

STATE OF SOUTH CAROLINA,
Plaintiff,
v.
DONALD T. REGAN, SECRETARY OF THE TREASURY OF THE UNITED STATES OF AMERICA,
Defendant.

On Motion for Leave to File Complaint

APPENDIX OF THE NATIONAL ASSOCIATION OF COUNTIES, THE NATIONAL CONFERENCE OF STATE LEGISLATURES, THE U.S. CONFERENCE OF MAYORS, THE COUNCIL OF STATE GOVERNMENTS, THE MUNICIPAL FINANCE OFFICERS ASSOCIATION, BILL GUNTER, TREASURER OF THE STATE OF FLORIDA, EDWARD V. REGAN, NEW YORK STATE COMPTROLLER AND THE STATE OF WEST VIRGINIA

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WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

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IN THE
SUPREME COURT OF THE UNITED STATES
October Term, 1982

No. 94, Original

STATE OF SOUTH CAROLINA,
Plaintiff,

vs.

DONALD T. REGAN, SECRETARY OF THE TREASURY OF THE UNITED STATES OF AMERICA,
Defendant.

AFFIDAVIT OF JAMES H. KERLEY, JR.

STATE OF TEXAS •
•
COUNTY OF DALLAS •

Personally appeared before me, James H. Kerley, Jr., known to me, and being duly sworn, stated:

1. I am Executive Vice President of First Southwest Company of Dallas, Texas, an investment banking firm, and have been actively involved in municipal bond procedures in Texas for 32 years.

2. First Southwest Company, organized in 1946, is one of the oldest and most active regional investment banking firms based in the State of Texas. Our Company is a leader in the field of financial advisory work, assisting various authorities, state agencies, districts, counties, colleges, schools and airports in the design and marketing of tax-exempt obligations. During the five-year period

of 1978-1982, we assisted in the design, economics, preparation, marketing and delivery of 982 bond issues, totaling over $10.7 billion. For our fiscal year ended March 31, 1983, we provided financial advisory services to 154 municipal clients in 268 issues totaling more than $3.2 billion in municipal obligations.

3. In addition, First Southwest Company also provides the full-range of activities broadly encompassed by the term "investment banking", which includes the underwriting and marketing of taxable corporate securities.

4. Based on my long familiarity with both municipal tax-exempt issues and taxable corporate securities, removing the tax-exemption on the interest paid on municipal bonds would certainly cause interest costs to the municipal issuer to increase substantially. As an example, in today's market, a corporate issue rated "A" by Moody's Investors Services, Inc., maturing in 20 years, with a 10-year option, bears an interest rate around 12¾%. A tax-exempt municipal bond having the same rating, maturing in 20 years with a 10-year option, bears an interest rate of around 9.75%. This represents a differential of an additional 3% if municipal bonds should become taxable. Certain lower-rated issuers could conceivably be foreclosed from financing altogether by increased interest costs, and many worthwhile public purpose projects would not be feasible at such increased interest rates.

5. In my opinion, the removal of the tax-exemption on the interest paid on municipal securities, by causing the imposition of higher rates of interest, would do irreparable harm to the ability of certain issuers to finance needed public facilities in the State of Texas. Further, the disruption of the municipal securities market during the period that a myriad of state and local laws be restructured (some probably requiring Constitutional versions in many states) would be disastrous in many instances.

Further deponent saith not.

/s/ James H. Kerley, Jr.
JAMES H. KERLEY, JR.
Executive Vice President

[SEAL]

Sworn to and subscribed before me this 6th day of September, 1983.

/s/ Amanda V. Denham
Notary Public in and for
The State of Texas

My commission expires: 8-31-84

[SEAL]

IN THE
SUPREME COURT OF THE UNITED STATES
October Term, 1982

No. 94, Original

STATE OF SOUTH CAROLINA,
Plaintiff,

vs.

DONALD T. REGAN, SECRETARY OF THE TREASURY
OF THE UNITED STATES OF AMERICA,
Defendant.

AFFIDAVIT OF RICHARD L. TAUBER

STATE OF NEW YORK *
*
COUNTY OF NEW YORK *

Personally appeared before me, Richard L. Tauber, known to me as being duly sworn stated:

1. I am a Vice President in the Public Finance Department of Morgan Guaranty Trust Company of New York where I have been involved in the tax-exempt and taxable public securities markets for the past twenty-five years. In my current capacity I have been involved in underwriting the tax-exempt securities of state governments, major state agencies and municipalities across the United States.

2. Morgan Guaranty Trust Company of New York, a wholly-owned bank subsidiary of J. P. Morgan and Company, Inc. is the nation's fifth largest bank. As of June

30, 1983 the bank had assets in excess of $59 billion and capital and surplus of over $3 billion.

3. Morgan Guaranty Trust Company is a major underwriter and distributor of tax-exempt bonds and notes in the new issue market and an active participant in secondary market trading. In 1982, the Public Securities Association ranked Morgan Guaranty first among commercial bank dealers in volume of state and local government securities underwritten and thirteenth in overall underwriting among bank and non-bank dealers.

4. State and local governments have achieved significant savings on borrowing costs by issuing tax-exempt securities. The Tax Equity and Fiscal Responsibility Act of 1982 provides that any state and local government securities, with a maturity in excess of one year, sold after July 1, 1983, which are issued in *bearer form*, would not have tax-exempt status. Thus, state and local governments should their debt instruments not be in registered form, would be required to compete for capital with corporate borrowers in the taxable securities market. Some AAA-rated state securities, backed by the full faith and credit of the state, should be able to be sold in the taxable securities market at interest rates slightly below those of highly rated corporate borrowers. In general, however, the vast majority of issuing jurisdictions would have to issue securities at similar or higher taxable interest rates compared to those paid by corporations to attract investor interest.

5. In recent years, Aa rated long term tax-exempt securities have yielded between 64% and 78% of taxable corporate securities with comparable maturities and credit ratings. Therefore, removing the tax-exempt status of municipal securities would increase the interest cost for an Aa rated state or local government by some 30% to 60%. To illustrate this point, the average yield of twenty year Aa rated municipal bonds issued in the first

half of 1983 was 8.94% or 74% of taxable rates. Consequently, in order to be sold on a taxable basis, these bonds would have to yield approximately 12.07%.

6. The impact of the removal of tax-exemption for municipal issuers would be even greater for the smaller issuers. There are approximately 47,000 state and local governmental units which issue tax-exempt municipal securities. In 1982 63% of all new municipal issues were sold for a par value of under $5 million and 24% were sold for a par value of $1 million or less. In the first half of 1983 60% of all new issues were sold for a par value of under $5 million and 20% were sold for a par value of $1 million or less. These small issuers' securities are sold in regional markets as they have been for more than a century. As there is no comparable market for small, lesser known corporates, there is a question as to whether taxable local municipal issues could find a receptive market place.

7. Despite the large number of small issues in the municipal market the dollar volume is greater than the corporate market. In 1982 there were 6,339 new long-term municipal bond issues totalling $78.3 billion, whereas there were 642 new corporate bond issues for a total of $57.2 billion. The small size of municipal issues is underscored again in the first half of 1983 when 3,564 new long-term municipal issues have come to market totalling $45.9 billion compared to 361 new corporate bond issues totaling $31.6 billion.

8. In my opinion, the removal of Federal tax-exemption for municipal securities could adversely affect the ability of states and local governments to raise capital in the public market for public purpose projects. Moreover, in my judgment it is questionable whether many of the smaller issuing jurisdictions would have successful access to the public market at a fair rate thereby requiring them to seek even more costly sources of capital.

Further deponent saith not.

/s/ Richard L. Tauber
RICHARD L. TAUBER
Vice President

[SEAL]

Sworn to and subscribed before me this 13th day of September, 1983.

/s/ James C. P. Berry
JAMES C. P. BERRY
Notary Public in and for
The State of New York

My commission expires:
March 30, 1985

[SEAL]

IN THE
SUPREME COURT OF THE UNITED STATES
October Term, 1982

No. 94, Original

STATE OF SOUTH CAROLINA,
Plaintiff,

vs.

DONALD T. REGAN, SECRETARY OF THE TREASURY OF THE UNITED STATES OF AMERICA,
Defendant.

AFFIDAVIT OF CHARLES M. HARMON, JR.

STATE OF NEW YORK •
•
COUNTY OF MANHATTAN •

Personally appeared before me, Charles M. Harmon, Jr., known to me, and being duly sworn, stated:

I am a general partner of Goldman, Sachs & Co., New York, New York, which is one of the nation's largest investment banking firms. I personally have been involved in investment banking for over 23 years and currently serve as the senior partner and manager of Goldman, Sachs' Municipal Bond Department. I am also a member of the firm's investment banking policy committee which handles policy matters concerning the underwriting of all forms of corporate and government securities.

Goldman, Sachs & Co. has for many decades been ranked among the 10 leading managers of corporate underwritings. Since 1975, Goldman, Sachs & Co. has

consistently ranked among the 10 leading managers of municipal bonds and, generally, senior manages more revenue bond issues than any other firm. We are also a primary dealer in direct obligations of the United States Government and serve as a managing underwriter of obligations issued by Agencies of the United States Government and Agencies created by the United States Government. We are also the managing underwriter of bond issues for several other countries.

Based upon this knowledge and experience in underwriting of both tax exempt and taxable securities, I have concluded that if the tax exempt status of interest income earned on municipal securities were altered or eliminated, municipal entities would pay substantially higher rates of interest for funds borrowed. Moreover, many units of government would have to pay such high rates of interest or would have to repay principal over a shorter period of time, the combination of which or as separate causes, could make many needed projects unfeasable, uneconomical, and unfinanceable.

Many municipal projects are built through the issuance of revenue bonds. These bonds are payable solely from revenues to be derived from the project to be built. This has been true of many airports, port facilities, water supply systems (dams), etc., throughout the United States. On a comparative credit basis, these projects are similar to those financed with venture capital in the corporate sector. However, projects such as the Dallas-Fort Worth Regional Airport cost over $300,000,000 for the initial phase. This amount of money is not available on a venture capital basis. Money borrowed on a taxable basis, if available, would probably have had a repayment schedule equal to less than half the maturity life of that available in the tax exempt market. The interest rate would have been at least twice as much and probably three times greater than which was obtained in the tax exempt market. In that the Dallas-Fort Worth Airport project was only marginally feasable with a 30-year tax

exempt low interest rate bond financing, it is highly doubtful that the project would have ever been financed with taxable bonds, when the combined annual payments of principal and interest charges over a 15-year period would have been several times greater. And all the economic growth in that metroplex, which has been attributed to the establishment of that major transportation facility, would not have occurred. The same would be true of the toll road and toll bridge projects in the state. Without tax exempt financing, Atlanta's rapid transit system would not have been economically feasable, and as such not financeable. Without tax exempt financing, Dallas will never build a system.

A key difference between many municipal projects and those of the private sector, is that profit opportunity is marginal at best. Through the municipal system of finance, i.e., long payout period, lower rates of interest and 100 percent debt financing, projects become economical and financeable.

In my opinion, removing the tax exempt status of interest earned on municipal bonds will not only increase the cost of borrowing for municipal units of government, but it will result in many necessary projects never being constructed.

Further deponent saith not.

/s/ Charles M. Harmon, Jr.
CHARLES M. HARMON, JR.
General Partner
Goldman, Sachs & Co.

Sworn to and subscribed before me this 8th day of September, 1983.

/s/ Janet L. Zuper
Notary Public in and for
the State of New York

My commission expires:
Mar. 30, 1984

IN THE
SUPREME COURT OF THE UNITED STATES
October Term, 1982

No. 94, Original

STATE OF SOUTH CAROLINA,
Plaintiff,

vs.

DONALD T. REGAN, SECRETARY OF THE TREASURY
OF THE UNITED STATES OF AMERICA,
Defendant.

AFFIDAVIT OF C. W. HOUSER

STATE OF TEXAS *
*
COUNTY OF TRAVIS *

Personally appeared before me, C. W. Houser, known to me, and being duly sworn, stated:

1. I am Senior Vice President of First City National Bank of Austin (hereinafter the Bank) and have been actively involved in municipal bond procedures for banks in Texas for 38 years. The Bank is one of 61 banks in Texas which together comprise First City BAN Corp., a bank holding company, all of said banks being involved actively in the processing of municipal bonds issued in the State of Texas.

2. The Bank is the third largest bank in Austin with assets of $610,000,000. It is the primary registrar bank in Austin for municipal issuers of registered bonds, and

is a leading registrar bank for the State as a whole due to its location in Austin, acting as registrar for approximately 35-40% of all Texas municipal issues.

3. The Bank also deals extensively with taxable corporate securities.

4. Based on my long familiarity with both municipal tax-exempt issues and taxable corporate securities, I estimate that removing the tax-exemption on the interest paid on municipal bonds would cause interest costs to the municipal issuer to rise between 50% and 75%. For example, an issuer with the highest ratings for its tax-exempt paper, such as The University of Texas, is presently able to issue at an interest rate of 10%. If that paper were not tax-exempt, the interest rate would be between 15% and 17%. An issuer with a lower credit rating than The University of Texas would be forced to pay over 17% on taxable interest (since such an issuer pays higher than 10% on its tax-exempt paper). Certain lower-rated issuers could conceivably be foreclosed from financing altogether by increased interests costs. Lower-rated issuers than The University of Texas include the bulk of Texas school districts, charged with constructing and equipping the schools of the State, and the bulk of Texas counties, which construct and equip many of the State's prison facilities.

5. In my opinion the removal of the tax-exemption on the interest paid on municipal securities, by causing the imposition of higher rates of interest would do irreparable harm to the ability of certain issuers to finance needed facilities in the State of Texas.

Further deponent saith not.

/s/ C. W. Houser
C. W. HOUSER
Senior Vice President

[SEAL]

Sworn to and subscribed before me this 2nd day of September, 1983.

/s/ Mecy Leiser
Notary Public in and for
The State of Texas

My commission expires: 11/30/84

[SEAL]

IN THE
SUPREME COURT OF THE UNITED STATES
October Term, 1982

No. 94, Original

STATE OF SOUTH CAROLINA,
Plaintiff,

vs.

DONALD T. REGAN, SECRETARY OF THE TREASURY
OF THE UNITED STATES OF AMERICA,
Defendant.

AFFIDAVIT OF TERRENCE E. COMERFORD

STATE OF CALIFORNIA *
*
CITY AND COUNTY OF SAN FRANCISCO *

Personally appeared before me, Terrence E. Comerford, known to me, and being duly sworn, stated:

1. I am a Managing Director of Blyth Eastman Paine Webber Incorporated ("BEPW") and am in charge of BEPW's public finance activities on the West Coast. I have been actively engaged in assisting political subdivisions raise capital through the competitive sale or negotiated underwriting of tax-exempt securities for over 25 years.

2. Among the many issuers of such tax-exempt securities that I have personally have been involved with on a client basis are the states of Alaska, Arizona, California, Hawaii and Nevada or agencies thereof, cities such as

Anchorage, Chicago, Fresno, Los Angeles, Ogden, Phoenix, Portland, Sacramento, San Diego and San Francisco and special districts such as the Imperial Irrigation District, the Sacramento Municipal Utility District and the Southern California Rapid Transit District.

3. BEPW has consistently ranked among the leading underwriters of tax-exempt securities in the nation according to industry sources and historically has maintained a prominent position in the origination and distribution of corporate (taxable) securities.

4. Based upon my extensive experience with issuers of tax-exempt securities and general familiarity with taxable federal government and corporate offerings, the removal of tax exemption on the interest of locally incurred indebtedness would deny access to the capital market for many political subdivisions, especially the smaller or less well known issuers, and would surely raise the borrowing cost to those continuing to enjoy such access. The magnitude of the increased borrowing cost cannot be measured in interest rate differential alone, which is partially a function of the tax bracket of the investor, but must also consider the increased principal amount of a bond issue which may include funded interest during the construction period and establishment of a reserve fund equal to maximum annual debt service for a revenue supported offering at higher taxable rates.

Additionally, traditional "coverage" requirements for revenue bond offering (e.g., net revenues after operation and maintenance must equal 125% or more of debt service) would force user charges for the revenue producing facility to higher levels than those now required for tax-exempt financings. Faced with growing demand for life-line water, electric, sewer and telephone charges, taxable financing of municipal utilities providing these vital services would be an increased burden on life-line and other users.

Although comparison of taxable vs. tax-exempt yields have been made for many years as an indication of the relative tax benefit of the latter, and yields on similarly rated taxable and tax-exempt bonds have been cited as a reason to purchase a particular security, removal of tax exemption would eliminate some of the meaningful comparisons now available. Instead, taxable municipal offerings would be compared on strictly a yield basis, often with better known, thoroughly analysed taxable offerings, including those of the federal government.

It has been alleged by some that the market for municipal issues would be broadened if they were taxable, thus appealing for example, to pension funds and life insurance portfolios. I submit that this does not necessarily follow uniformly since some of the innovative financing techniques developed and utilized by political subdivisions would not be understood nor embraced by the portfolio manager accustomed to analysing corporate indebtedness and comfortable in his fiduciary role. Historically, the maturities of municipal offerings have been longer than those of most corporate debt which often is related to the economic or depreciable life of the asset being financed, another disadvantage to municipal issuers were they to be forced to compete with taxable issuers on the same terms.

Removal of tax exemption on the interest of municipal indebtedness will, in my judgment, raise the cost of capital to all other borrowers because of the increased supply of financing competing for funds on the same terms. It has been suggested earlier that certain municipal issuers will be denied access to capital at any cost, but with the volume of tax-exempt borrowing exceeding $70 billion in recent years, nearly twice that of corporate borrowers, the impact on the market place must be a negative one, reflected by increased rate levels.

5. In my opinion, the removal of tax exemption on municipal securities issued by my clients, many of them

political subdivisions or instrumentalities of the state of California, would result in an increased borrowing rate of 25% to 30% (from 10% to 12.5% or 13%) under present market conditions, without giving effect to the increased par value required to fund a project (interest and debt service reserves) at the higher borrowing level.

Further deponent saith not.

/s/ Terrence E. Comerford
TERRENCE E. COMERFORD
Managing Director

Sworn to and subscribed before me this 7 day of September, 1983.

/s/ W. G. Lashbrook III
Notary Public in and for
The State of California
City and County of San Francisco

My commission expires:

Dec. 18, 1984

IN THE
SUPREME COURT OF THE UNITED STATES

AFFIDAVIT OF JOHN E. PETERSEN

---

1. I am Director of the Government Finance Research Center of the Municipal Finance Officers Association, located in Washington, D.C., and have been active in the areas of public finance and the municipal bond market for the past 17 years.

2. The Government Finance Research Center (GFRC) is a separate operating division of the Municipal Finance Officers Association (MFOA) devoted entirely to research activities. Located in Washington, D.C., the Center was created in 1977 to manage and conduct research relating to a full range of public finance issues. The parent organization, MFOA, serves the government finance profession by improving the knowledge, skills, and performance of those responsible for government fiscal policy and management. MFOA members are from city, county, state, provincial, and federal governments, school and other special districts, retirement systems, colleges, universities, public accounting firms, and financial institutions.

3. A general obligation bond is generally understood to be a full-faith-and-credit obligation of a governmental entity that has taxing authority. Operationally, this means the security is backed by a pledge to levy and collect taxes in sufficient amount to pay the debt service (principal and interest) on time and in full.

4. Loss of Federal tax-exemption would substantially increase the interest rates that state and local governments would have to pay on borrowed funds. As a gen-

eral rule, one would expect that taxable state and local government issues would carry the same interest rates as currently taxable securities of comparable credit quality and maturity. There are various structural and procedural differences between the "corporate" and "municipal" bond markets, the long-term interest rates on new-issue corporate securities, as contained in broadly-based market indices, are the best overall indicator of the rates state and municipal issuers might expect to pay were the interest on their bonds taxable.

For the second quarter of 1983, the average interest cost on a twenty-year state and local bond, using widely-followed *Bond Buyer* 20-Bond Index, was 9.82 percent. As regards taxable interest rates, the Moody's "All-Grade" Long-Term Corporate Bond Index for the same quarter averaged 12.43 percent. (Both these indices cover a spectrum of qualities in their components, but on balance reflect a credit quality of A to Aa, using the Moody's rating definitions.)

The difference of 2.61 percentage points approximates the added interest rate were the bonds to be taxable at this time. The difference will vary over time depending on supply and demand conditions in the credit markets and the general level of interest rates. For the year 1982, the difference in these two market averages was 2.98 percentage points. It is my opinion that the added interest cost, depending on market conditions, would, were tax-exemption to be removed, be between 2.5 and 3 percentage points on long-term bonds.

5. In 1982, according to the Public Securities Association, a total of $20,879 million in long-term general obligation bonds were sold by state and local governments. With a 2.5 to 3 percentage point increase in borrowing cost, this would amount to $522 to $626 million in added interest costs annually. Were these bonds to be outstanding on an average of 12 years, this would amount to $6,264 million to $7,512 million in added interest costs

over the lifetime of the bonds sold that year. The added interest cost on borrowing would accumulate with each year's new issuance. Thus, the total added interest cost would amount to a multiple of one year's added costs equal to roughly the number of years since they became subject to taxation times the increase in the annual interest rate.

6. Loss of tax-exemption would increase the annual interest rate on the general obligation bonds of state and local governments by 2.5 to 3 percentage points, and would increase the interest payments on newly issued debt by 25 to 30 percent above their current levels. This, over time, would constitute a substantial burden to state and local governments.

/s/ John E. Petersen
JOHN E. PETERSEN, Director
Government Finance Research Center
September 20, 1983

I declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge.

/s/ John E. Petersen
JOHN E. PETERSEN, Director
Government Finance Research Center

Sworn to and subscribed before me this 20th day of September, 1983.

Linda A. Hosted
Notary Public in and for
the District of Columbia

My commission expires: December 14, 1986.

Office-Supreme Court, U.S.
FILED
MAY 5 1983
ALEXANDER L. STEVAS
CLERK

NO. 94, Original

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1982

STATE OF SOUTH CAROLINA,
Plaintiff,

vs.

DONALD T. REGAN, SECRETARY OF THE TREASURY OF THE UNITED STATES OF AMERICA,
Defendant.

AMICUS CURIAE BRIEF OF TEXAS, ALASKA, ARIZONA, GEORGIA, INDIANA, IOWA, LOUISIANA, MARYLAND, MISSISSIPPI, MISSOURI, MONTANA, NEVADA, NEW HAMPSHIRE, NORTH CAROLINA, NORTH DAKOTA, OHIO, OKLAHOMA, PENNSYLVANIA, RHODE ISLAND, TENNESSEE, VERMONT, VIRGINIA, WISCONSIN AND WYOMING

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NO. 94, Original

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1982

STATE OF SOUTH CAROLINA,
Plaintiff,

vs.

DONALD T. REGAN, SECRETARY OF THE TREASURY OF THE UNITED STATES OF AMERICA,
Defendant.

INTEREST OF AMICUS CURIAE

The interest of *amicus curiae* filed pursuant to Rule 36.4 of the Rules of the Supreme Court of the United States for Texas, Alaska, Arizona, Georgia, Indiana, Iowa, Louisiana, Maryland, Mississippi, Missouri, Montana, Nevada, New Hampshire, North Carolina, North Dakota, Ohio, Oklahoma, Pennsylvania, Rhode Island, Tennessee, Vermont, Virginia, Wisconsin and Wyoming is in elaborating the consequences of (1) the Court's refusal to entertain South Carolina's Motion to the Original Jurisdiction of the Court and (2) the implementation of Section 310(b)(1) of the Tax Equity and Fiscal Responsibility Act of 1982 requiring that municipal bonds be issued in registered form in order that the interest thereon be exempt from Federal income taxation.

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ARGUMENT

QUESTIONS PRESENTED

I. Is there a serious controversy upon which the Court should exercise its Original Jurisdiction?

   A. Is the State as State damaged?

   B. Does the State have an interest in redressing the damage done to its political subdivisions?

II. Is the Supreme Court the proper forum for the complaint which South Carolina has moved for leave to file?

III. Is the implementation of Section 310(b)(1) of the Tax Equity and Fiscal Responsibility Act an unconstitutional exercise of Congressional taxing power?

JURISDICTION

The sovereign State of South Carolina has invoked the original jurisdiction of the Court according to the jurisdictional grant bestowed in Article III, Section 2 of the United States Constitution providing original jurisdiction in a case or controversy between a State and a citizen of another State. South Carolina, as a sovereign State in the federal system seeks redress against Donald T. Regan, Secretary of the Treasury of the United States, currently a resident of the State of Virginia. The States of Texas, Alaska, Arizona, Georgia, Indiana, Iowa, Louisiana, Maryland, Mississippi, Missouri, Montana, Nevada, New Hampshire, North Carolina, North Dakota, Ohio, Oklahoma, Pennsylvania, Rhode Island, Tennessee, Vermont, Virginia, Wisconsin and Wyoming, consistent with Rules of the Supreme Court, Rule 36.4 files this Brief of Amicus Curiae in the action of South Carolina.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Tenth Amendment to the United States Constitution provides:

> The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.

The Sixteenth Amendment to the United States Constitution provides:

> **The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.**

Section 310(b)(1) of the Tax Equity and Fiscal Responsibility Act of 1982 provides:

(b) OTHER OBLIGATIONS. —

(1) OBLIGATIONS MUST BE IN REGISTERED FORM TO BE TAX-EXEMPT.—Section 103 (relating to interest on certain governmental obligations) is amended by redesignating subsection (j) as subsection (k) and by inserting after subsection (i) the following new subsection:

'(j) OBLIGATIONS MUST BE IN REGISTERED FORM TO BE TAX-EXEMPT.—

'(1) IN GENERAL.—Nothing in subsection (a) or in any other provision of law shall be construed to provide an exemption from Federal income tax for interest on any registration-required obligation unless the obligation is in registered form.

'(2) REGISTRATION-REQUIRED OBLIGATION.—The term "registration-required obligation means any obligation other than an obligation which—

'(A) is not of a type offered to the public,

'(B) has a maturity (at issue) of not more than 1 year or

'(C) is described in section 163(f)(2)(B).

'(3) SPECIAL RULES.—

'(A) BOOK ENTRIES PERMITTED.—For purposes of paragraph (1), a book entry obligation shall be treated as in registered form if the right to the principal of, and stated interest on, such obligation may be transferred only through a book entry consistent with regulations prescribed by the Secretary.

'(B) NOMINEES.—The secretary shall prescribe such regulations as may be necessary to carry out the purpose of paragraph (1) where there is a nominee or chain of nominees.'

STATEMENT

On February 9, 1983, the State of South Carolina moved for leave to file a complaint to the original jurisdiction of the Court contesting the constitutionality of Section 310(b)(1) of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) because it infringes on rights of state sovereignty guaranteed by the Tenth Amendment to the United States Constitution. Section 310(b)(1) provides that, in order to be exempt from Federal income taxation, any obligation of a State or municipal issuer must be in registered form effective July 1, 1983. Donald T. Regan is responsible for administering and enforcing Section 310(b)(1) under the dictate of 26 U.S.C. Section 7801. South Carolina has moved to the Court's original jurisdiction as a sovereign in the federal system seeking redress against the acts of a citizen of a foreign state. Texas, Alaska, Arizona, Georgia, Indiana, Iowa, Louisiana, Maryland, Mississippi, Missouri, Montana, Nevada, New Hampshire, North Carolina, North Dakota, Ohio, Oklahoma, Pennsylvania, Rhode Island, Tennessee, Vermont, Virginia, Wisconsin and Wyoming, herein file this brief of *amicus curiae* both as to the jurisdictional question and on the merits of the claim.

SUMMARY OF ARGUMENT

South Carolina's action puts into issue the constitutionality of Section 310(b)(1) of the Tax Equity and Fiscal Responsibility Act of 1982 as an attempt to impermissibly infringe on an essential governmental function of a sovereign State in the federal system.

The Court can and should entertain this motion to its original jurisdiction because a serious claim of grave constitutional magnitude can be shown as regards the rights of the State as State or as the State representing the rights of its political subdivisions. The original jurisdiction of the Supreme Court is the only forum which can adequately redress the injury of which South Carolina complains.

There is a complete lack of constitutional authority for the discriminatory classification of municipal obligations into a taxable form (bearer paper) and a nontaxable form (registered paper), as Congress was not granted power to tax the incidences of state sovereignty by either an original Constitutional grant or by the Sixteenth Amendment. As the express authority to tax the sovereign functions of a State is not granted in the Constitution, Congress is constitutionally precluded from the exercise of such power by the Tenth Amendment.

The Court should therefore grant original jurisdiction in the cause and find Section 310(b)(1) of the Tax Equity and Fiscal Responsibility Act an unconstitutional exercise of the taxing power of Congress.

ARGUMENT

I. South Carolina has presented a substantial constitutional claim over which the court should exercise its original jurisdiction.

A. The State as State is the real party in interest.

South Carolina has ably set forth in its brief supporting its Motion for Leave to File a Complaint (Brief of South Carolina at 34, 36, 39, 40) the imminent financial damage that the state will suffer if forced to comply with the provisions of Section 310(b)(1) of the Tax Equity and Fiscal Responsibility Act ("Section 310(b)(1)" of "TEFRA") requiring municipal securities be issued in registered as opposed to bearer form to retain their tax-exempt status. (Pub. L. No. 97-248, Tax Equity and Fiscal Responsibility Act of 1982, Section 310(b)(1).). The damage is imminent to every state in the federal system. By way of example, the Municipal Advisory Council of Texas (MAC), based on the charges of registrar banks as opposed to paying agent banks, has projected that costs of bond issuance will rise, depending on the size of the issue, between 1435% and 156%. See MAC Affidavit, Appendix. Further, financial damage will also result to the States with enforcement of Section 310(b)(1) due to increased costs of issuance: for example, filings of IRS Form 1099, not previously required, added costs of including registrar agreements for disclosure purposes in Official Statements, and higher interest rates. See Affidavit of Indianapolis Controller, Appendix. As such, threatened implementation of the law and its effect on the States creates a controversy of sufficient merit and seriousness to invoke the Court's original jurisdiction. See *Massachusetts v. Mellon*, 262 U.S. 447 at 484 (1923). See also *Illinois v. City of Milwaukee*, 406 U.S. 91, 94 (1981).

In the opinion of the State of Texas, irreparable harm to sovereign state functions results from the Secretary of the Treasury's proposal to enforce a law passed with no constitutional authorization because such law affects the borrowing capacity of a State or its political subdivisions. It is undisputed that the Federal government has a co-equal power with the States which form the Federal

union to levy taxes, but there is nowhere granted the power to tax a fellow sovereign. *Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429 at 584 (1895) states:

> "The federal government in its appropriate sphere is supreme: but the States within the limits of their powers not granted, or, in the language of the tenth amendment, 'reserved' are as independent of the general government as that government within its sphere is independent of the States."

While Section 310(b)(1) of TEFRA does not directly tax State and municipal borrowing, it does impose a tax on such obligations if issued in bearer form. This conflicts directly with the State performing its governmental objectives in the most economical fashion because a lower rate of interest is available if it issues its obligations in bearer form. Issuing debt is "an operation essential to the important objectives for which the government was created," for that debt is issued to enable the government to accomplish its governmental functions. In *Weston v. City Council of Charleston*, 27 U.S. (2 Pet.) 449, 467 (1829), the Court found to be an impermissible burden on the functions of a government, a tax on "an operation essential to the important objectives for which the government was created". With Section 310(b)(1) the Congress seeks to impose a tax on an aspect of such an operation—on municipalities' capital formation process. The power to tax those operations essential to the fundamental aspects of a state government, according to *Weston*, supra, does not lie in the original grant of taxing power to the United States government. See also *Memphis State Bank & Trust Company v. Riley C. Garner*, _____U.S._____, 51 U.S.L.W. 4104, 4105 (1983), finding unconstitutional a discriminatory state tax where the "economic but not the legal incidence of the tax falls on the Federal

Government" (Tennessee had levied a 3% tax on banks for income earned on Treasury obligations, but not on Tennessee obligations) and *Washington v. United States,* _____U.S._____, 51 U.S.L.W. 4305 (1983).

Just as clearly, no such power is granted by the Sixteenth Amendment to the United States Constitution. While that amendment provides that "Congress shall have the power to tax all income from whatever source derived", it was intended to enable the Federal government to levy income tax, not a tax on essential objectives of its fellow sovereigns. The States, in fact, were assured at the time of passage that the Sixteenth Amendment was not intended to convey power to tax the States. 45 Cong. Rec. 1696 (1910). See also Goldberg, Arthur Abba, *A Call to Action: State Sovereignty, Deregulation and the World of Municipal Bonds,* 13 Urban Lawyer 253, 258, 259 (1981). Congress has twice proposed an *additional* constitutional amendment to end the exemption of interest on state obligations from federal income taxation with no success. 65 Cong. Rec. 43, 347 (1924) and 76 Cong. Rec. 3588 (1933). Congress has similarly been unsuccessful in repealing the statutory exemption on interest earned on state and municipal securities granted in Act of October 3, 1913, ch. 166, 38 Stat 168. Attempts at repeal failed in 1922, 1923, 1924, 1938, 1942, 1949, 1951, 1954 and 1959. Goldberg, supra at 259.

By what authority then, does the Secretary of the Treasury enforce a law with no colorable claim to constitutional authorization? Congress, after all, has only those powers explicitly granted by the Constitution; all others are reserved to the States and the people by operation of the Tenth Amendment. As the Court stated in *National League of Cities v. Usery,* 426 U.S. 833 at 845 (1976):

> We have repeatedly recognized that there are attributes of sovereignty attaching to every

> state government which may not be impaired by Congress, not because Congress may lack an affirmative grant of legislative authority to reach the matter, but because the Constitution prohibits it from exercising the authority in that manner.

It is the responsibility and duty of the States as States to protect their interests in this regard. The situation at hand is a challenge to just such interests.

B. The State has a real interest in the profound damage being done to the financing capacity of its political subdivisions.

The State must act to protect its political subdivisions' interests in financing essential governmental functions:

> A municipal corporation is the representative of the state and one of the instrumentalities of the state government.
>
> *Pollock,* supra, at 584

Municipalities of the State with the capacity to issue tax-exempt debt will suffer the same increased costs and other onerous burdens as the State if Section 310(b)(1) of TEFRA is allowed to go into effect. For smaller issuers, those with the least capacity to protect their interests, the costs of complying with registration will be proportionately higher than those of larger issuers. See MAC Affidavit, supra.

Pollock, quoting from *United States v. Baltimore & O.R.Co.,* 84 U.S. (17 Wall) 322 (1873) states that a municipal corporation is a creature of the State created to exercise a limited portion of the State's powers. *Pollock,* supra at 584. As municipalities of a State are its creatures, exercising a portion of the *State's* powers,

the State must and should be permitted to represent those subdivisions unconstitutionally deprived of their ability to exercise those powers.

II. The Court is the only forum available which can do full equity to the claim of South Carolina.

The sovereign State of South Carolina has briefed the substantial financial costs and complications to its financing arrangements which will result from enforcement of Section 310(b)(1) of TEFRA. Brief of South Carolina, supra. The Court in *National League of Cities*, supra, at 254-256, dwelt at length on the constitutional infirmity of such financial burden on an essential state function. While standing may be available in other forums, incalculable financial damage will be done to an essential sovereign function if the matter is not expeditiously resolved. The Court is the only forum in which such treatment is possible.

Further, there is no other forum which can fulfill the test outlined by the Court for the exercise of its original jurisdiction. *Massachusetts v. Missouri*, 308 U.S. 1, 18 (1939). The test examines (1) "... the essential quality of the right asserted ..." and (2) "... whether recourse to that jurisdiction ... is necessary for the state's protection." See also *Illinois v. City of Milwaukee*, supra, *Washington v. General Motors Corp.*, 406 U.S. 109, 113 (1972) and *Maryland v. Louisiana*, _____U.S._____, 101 S.Ct. 2114, 2138 (1981) (dissent). In the situation at bar, the right of the first part of the test is the sovereign ability of a State to finance its integral governmental activities without unauthorized interference of its fellow sovereign. The second part is satisfied by the tremendous financial damage which will be done to the State before the issue can be resolved in another forum. If the Court refuses to entertain South Carolina's Motion, the damage done will be beyond any court's capacity to remedy it.

In refusing to entertain a motion to its original jurisdiction on the grounds of being an unsuitable forum in *Ohio v. Wyandotte Chemicals Corp.*, 401 U.S. 493, 499 (1971), the Court stated:

> ...we may decline to entertain a complaint brought by a State against the citizens of another State or country only where we can say with assurance that (1) declination of jurisdiction would not disserve any of the principal policies underlying the Article III jurisdictional grant and (2) the reasons of practical wisdom that persuade us that this Court is an inappropriate forum are consistent with the proposition that our discretion is legitimated by its use to keep this aspect of the Court's functions attuned to its other responsibilities.

The Court admitted that it had original jurisdiction, but, in this case, refused to exercise it on the basis that the principal purposes of the Article III jurisdictional grant could be served by a state court with concurrent jurisdiction. See 401 U.S. at 500. The *Ohio* case dealt with state law questions and common law nuisance doctrine, not with important problems of federal law as to which the Court stated "... we are the primary overseers." See 401 U.S. at 497, 498.

The Court in *Ohio* further found that as a primarily appellate tribunal it was ill-equipped to deal with a dispute which was "not so much the law as the facts." See 401 U.S at 503, 504. The issue at question in South Carolina's motion is not a factual question; it is a question of law, which would in any event be determined by the judge in a trial court: Is there, as a matter of law, constitutional authority for the implementation of Section 310(b)(1) of TEFRA?

As delineated above and in South Carolina's brief, there is no other court in this instance which can properly fulfill the purpose of the Article III jurisdictional grant. It is respectfully submitted that if the Court follows its own tests outlining appropriate cases in which to exercise its original jurisdiction, it will reach the conclusion that, as the only available forum with the power to do full equity to the claim, it must accept jurisdiction of South Carolina's action.

III. Implementation of Section 310(b)(1) of TEFRA is an unconstitutional exercise of the otherwise legitimate federal power to tax.

This Court's latest analysis of the limits placed on exercise of an otherwise legitimate use of Congressional authority by the Tenth Amendment reiterates the test laid down in *Hodel v. Virginia Surface Mining & Reclamation Association, Inc.*, 452 U.S. 264, 286-288 (1981). Such authority will be limited with showings:

> (1) ...that the challenged statute regulates the States as States.
> (2) that the regulation addressed matters that are indisputable attributes of state sovereignty.
> (3) that compliance with the statute would directly impair the ability of the State to structure integral operations in areas of traditional governmental functions.
> (4) that, assuming the challenged statute meets all the above requirements, the importance of the federal interests outweighs the impairment of state sovereignty.
>
> Equal Employment Opportunity Commission v. Wyoming, _____ U.S._____, 51 U.S.L.W. 4219, 4220, (1983)

As to the first prong of the test, there is clear regulation of the State as State in the present situation. While the incidence of the tax falls on the holder of the bond issued in bearer form, the injury done to the State by virtue of increased borrowing costs can "fairly be traced to the challenged action of the defendant." *Maryland v. Louisiana*, supra, quoting *Simon v. Eastern Kentucky Welfare Rights Organization*, 426 U.S. 26, 41-42 (1976). See also *Memphis State Bank*, supra. If the State issues obligations in registered form, it will be burdened with increased costs of issuance including higher rates of interest. Brief, supra, at I(A). See also Affidavit of Indianapolis, supra. If the State issues obligations in bearer form, they will be taxable, and, as such, will have to bear a higher rate of interest to be marketable.[1] Thus, the effect of the proposed regulation will, in either situation, increase the costs of the State's borrowing. The classification established by Section 310(b)(1) will impermissibly affect the States and their political subdivisions whether they choose to issue registered or bearer paper.

For example, the City of Indianapolis, faced with the prospect of having to issue all its obligations in registered form, decided to issue a series of fully registered park bonds. The syndicate manager eventually sold all the bonds, but Indianapolis ended up with interest costs about forty basis points higher than it would have had with bearer bonds—in absolute terms, increased interest costs of about $301,000 over the life of the bonds. Affidavit of Indianapolis, supra.

One need only multiply this figure by the number of municipal issuers of bearer bonds and the number of times they go to market annually to arrive at some no-

1. Because no tax has been imposed by the federal government on interest earned on state and local government obligations, these instruments have traditionally been marketed at interest rates below conventional interest rates.

tion of the increased expense in interest costs alone. It is no answer to say that the problem will correct itself when no issuer can issue bearer paper, for, as South Carolina's brief points out, there will be bearer bonds which already have been issued in the marketplace for decades to come. Texas argues further that even if bearer paper is eventually replaced by registered paper, it will be more costly than the continued use of *tax-exempt* bearer paper. Supra at 9. See Affidavit of Indianapolis, supra and Affidavit of MAC, supra.

That the second prong of the test is met is indisputable. How is a State to exercise any attribute of state sovereignty without the power to finance that attribute? If a State extends the right to an education, it must have money to build schools. If a State would enforce its penal laws, it must have money to build jails.[2] In upholding a tax on capital gains from trading in municipal bonds as not impairing state sovereignty, this court nevertheless affirmed that a tax on state obligations *per se* was constitutionally prohibited as a tax upon a State's borrowing power, a tax forbidden by the very concept of a federal system of government. See *Wilcutts v. Bunn*, 282 U.S. 216, 224-225 (1931).

In addition to the effects outlined in addressing prongs one and two of the Court's test for those regulations which must fall under the Tenth Amendment (most of those effects also going to prong three), Texas submits for the Court's consideration that increased costs of borrowing will "impair the ability of the State to 'structure integral operations in areas of traditional governmental functions'", *Hodel*, supra, at 287-288,

2. In Texas, the financial aspects of these attributes of state sovereignty are delegated to political subdivisions, but those subdivisions, too, suffer the same disability as the State: they must have money to perform the attributes of state sovereignty they are commanded by state law to implement.

EEOC, supra, at 4222. When the State and its subdivisions must pay more to meet their borrowing needs, there will be less available money to finance their operating costs. What is the profit to a town of building a new fire station, if, due to increased costs of borrowing, it can neither afford to purchase a fire truck nor pay the salaries of personnel to man the station? There is no use in a school without teachers. A prison without guards would hardly serve the purpose of incarcerating wrongdoers.[3] The greater the amount of money which must be raised to meet increased borrowing costs, the less money will be available for other governmental functions. See *National League of Cities*, supra, at 254-256.

Finally, the fourth part of the test which the Court reaffirmed in *EEOC*, supra—that the extent of the Federal interest advanced justifies the impairment to state sovereignty—is failed by the threatened implementation of Section 310(b)(1) of TEFRA. There is a question as to Federal interest at all. The position of the State of Texas is that the tax-exempt instances of State and local borrowing is a constitutional right. See, Brief, supra, Section I(A). Because the tax-exemption on the interest of State and local obligations is a matter of constitutional right, there can be no Federal interest at all in revenues lost to the Treasury by reason of the tax-exemption. If there is no Federal interest at all, there can be no constitutional impairment of state sovereignty given that the first three prongs of the test are met.

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3. It should be noted that virtually every prison facility in the State of Texas is under federal mandate to improve its conditions. See *Ruiz v. Estelle*, 503 F.Supp. 1265 (S.D. Tex. 1980), affirmed 650 F.2d 555 (5th Cir. 1981). This must include expansion of the facilities themselves. Once the money is borrowed to expand those facilities, there must yet be money left to improve the facilities, to provide more humane conditions of incarceration.

Assuming, *arguendo*, that there is a Federal interest, the State of Texas asserts that it is not of sufficient magnitude to impair such a fundamental aspect of state sovereignty. On November 20, 1982, the Joint Economic Committee of Congress released a Treasury Department study stating that the tax exemption on municipal bond interest "costs" Treasury $4.6 billion a year in "lost" individual income tax. However, the purported loss in tax revenue was only ranked tenth in total cost to the Treasury with the deduction for state and local taxes costing $26.5 billion, property tax deductions for owner-occupied homes costing $8.6 billion and other state and local tax write-offs costing $17.8 billion. *The Weekly Bond Buyer,* November 29, 1982, at 1 and 95. When Treasury itself ranks this "loss" of revenue tenth in importance, there is difficulty in ascertaining how the Federal interest can outweigh such an integral aspect of state sovereignty as the power to finance a State's governmental functions. There are at least three other sources of income noted above upon which Treasury could act first and "recover" more revenue, three deductions more clearly within the federal purview to disallow, at least within the constraints of the Tenth Amendment.

In *E.E.O.C.*, supra, the Court stressed that, in line with the holding in *National League of Cties,* supra, and *F.E.R.C. v. Mississippi,* 456 U.S. 742, 769-770 (1982), the degree of Federal interference with state sovereignty was the standard for determining an impermissible Tenth Amendment violation even when the Federal law 'directly impairs the States' ability to structure their integral operations' 51 U.S.L.W. at 4222. Even in striking down Wyoming's mandatory retirement age for game wardens and concluding that the Federal intrusion was not such an intrusion as to offend the Tenth Amendment, the Court stated that in some situations

> A State's employment relationship with its workers can...be one vehicle for the exercise of its core sovereign functions.
>
> 51 U.S.L.W. at 4222, n.11

The degree of interference was found permissible, not interference in all cases.

The implementation of Section 310 (b)(1), on the other hand, operates directly on a "core sovereign function" by regulating the essential sovereign power of the States to finance their governmental functions. There is no question that a State's financing is "one vehicle for the exercise of its core sovereign functions". Without financing a State would not be able to perform any "core sovereign function". There is a major difference between a State making an arbitrary decision that a game warden is unfit to fulfill the responsibilities assigned him after age fifty-five or sixty-five and a State making decisions in an attempt to finance its governmental functions at the lowest cost and with the least burden on its resources.

In addition to the "lost revenue" it associates with the tax exemption of interest on municipal bonds, the Treasury Department seems to have articulated a concern about the use of municipal bonds for the laundering of money from illegal transactions and to pass, untaxed, funds otherwise subject to taxation (notably, the passing of bearer bonds on death of the holder to an intended heir without passing the bonds through the decedent's taxable estate). *The Weekly Bond Buyer*, December 27, 1982, at 3. Texas submits that the Federal government has not demonstrated a sufficient Federal interest to punish States, in the face of the increased burden on the finances of every issuer of bearer bonds, for a use of their paper which is no fault of their own.

There can be no serious question that the Federal government has a substantial interest in preventing the avoidance of lawfully levied taxes. A solution should be found, however, that does not cause virtually as much financial damage to its innocent fellow sovereigns as it corrects for the Federal government. Through the vehicle of the Fifth Amendment, this Court has found the Federal government subject to similar constraints of equal protection and due process applicable to the States through the Fourteenth Amendment. See *Bolling v. Sharpe*, 347 U.S. 497 (1954). In the balancing of interests herein shown, Texas submits that the interests of the Federal government are out-weighed by the profound damage which will be inflicted on the system of federalism.

The Court recently held that a state tax on banks for interest earned on Treasury obligations was an impermissible burden on Federal borrowing costs, where banks were not taxed on interest earned on State obligations. *Memphis Bank & Trust*, supra. While the Court noted that such a tax was permissible if non-discriminatory, because the tax was not levied directly on the Federal government, the Court found that Tennessee here had enacted a law which discriminated against Federal obligations in favor of those of the State of Tennessee. Section 310(b)(1) of TEFRA similarly discriminations in favor of registered as opposed to bearer obligations. Treasury is placing an impermissible burden on State borrowing costs. Brief, supra, at I(A) and III. Affidavit of Indianapolis, supra. Affidavit of MAC, supra. Brief of South Carolina, supra, at 41, n.11. The Court expressed concern that if all fifty states were to enact such a law, the additional borrowing costs of the United States would be as much as $280 million. *Memphis Bank*, supra, at 4105, n. 8.

Section 310(b)(1) is a law which does affect fifty States and their countless political subdivisions. Texas sub-

mits that based on the experience of Indianapolis, the cost of this discriminatory law is likely to exceed the $280 million considered important in *Memphis Bank*. Affidavit of Indianapolis, supra. See also Affidavit of MAC. If there is any meaning left in the concept of federalism, Congress should not in this case be allowed to enact a law having the same effect as one which this Court found constitutionally prohibited to a State.

CONCLUSION

For the reasons above outlined the sovereign State of Texas urges that the Court grant South Carolina's Motion to the Court's original jurisdiction. As the Court stated in *Georgia v. Pennsylvania R. Co.*, 324 U.S. 439, at 466 (1971):

> Once a state makes out a case which comes within our original jurisdiction, its right to come here is established. There is no requirement in the Constitution that it go further and show that no other forum is available to it."

While practical considerations have narrowed the scope of that statement, it is demonstrated in South Carolina's brief and in the argument of the State of Texas that such considerations are not here applicable and the gravity of the imminent harm to the financing needs of all fifty States (and their political subdivisions and citizens) require that the Court accept original jurisdiction as the only acceptable forum.

The State of Texas has also demonstrated that the tremendous adverse financial impact of Section 310 (b)(1) on essential governmental functions of a sovereign State and its political subdivisions is without constitutional authorization. The proposed implementation of Section 310(b)(1) fails under every constitutional test:

the original grant of taxing power in the Constitution, the Sixteenth Amendment and the Tenth Amendment. A law with no constitutional authority is a law which cannot stand. "The question in this case is purely one of constitutional power", *E.E.O.C.*, supra, (Steven's concurrence) at 4226. That constitutional power simply does not exist.

The State of Texas would direct the Court's attention to the Defendant's own words on the subject of Federal taxation of municipal bonds as reported in The Weekly Bond Buyer, April 25, 1983 at 5:

> Mr. Regan said after giving testimony in Congress that "you would have to change the constitution" to impose a tax on municipal issues.

Respectfully submitted,

JIM MATTOX
Attorney General of Texas

DAVID R. RICHARDS
Executive Assistant

ROBERT T. LEWIS
Assistant Attorney General

MICHAEL CAFISO
Assistant Attorney General

SUSAN LEE VOSS
Assistant Attorney General

Attorney General of Texas
P.O. Box 12548
Austin, Texas 78711
(512) 475-4651

May _____, 1983

CERTIFICATE OF SERVICE

I, SUSAN LEE VOSS, an Assistant Attorney General for the State of Texas and a member of the Bar of the Court, do hereby certify that, in accordance with Rule 28.4(a), three (3) copies of the Amicus Curiae Brief in the matter of *South Carolina v. Regan* were served on all parties required to be served on this date by depositing same in the United States mail, first-class postage prepaid, and addressed as follows: The Honorable William French Smith, Attorney General of the United States, Department of Justice, 10th and Constitution Avenue N.W., Washington, D.C. 20530, The Honorable Rex E. Lee, The Solicitor General of the United States, Department of Justice, Washington, D.C. 20530; The Honorable Donald T. Regan, Secretary of the United States Treasury, Department of the Treasury, 1500 Pennsylvania Avenue, N.W., Washington, D.C. 20220; The Honorable T. Travis Medlock, Attorney General of the State of South Carolina, P.O. Box 11549, Columbia, South Carolina 29211; and The Honorable Richard W. Riley, Governor of the State of South Carolina, P.O. Box 11450, Columbia, South Carolina 29211.

This _____ day of May, 1983.

SUSAN LEE VOSS
Assistant Attorney General

P.O. Box 12548
Austin, Texas 78711

APPENDIX

No. 94, Original

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1982

State of South Carolina,

Plaintiff,

VS.

Donald T. Regan, Secretary of
the Treasury of the United States
of America,

Defendant.

AFFIDAVIT OF DANNY BURGER

State of Texas §
§
County of Travis §

Before me, the undersigned Notary Public, on this day personally appeared Danny Burger, known to me, and after being by me duly sworn on his oath deposed and said:

1. I am Executive Director of the Municipal Advisory Council of Texas, Inc. (hereinafter referred to as "Municipal Advisory Council"). The Municipal Advisory Council is a non-profit association made up of persons and entities involved in the business of underwriting, buying, and selling bonds and securities.

2. I have worked and been actively involved in the Texas bond business for over twenty-five years. From 1957 to 1963, I was a senior bond analyst with the

Municipal Advisory Council. From 1963 to 1968, I was the Municipal Bond Portfolio Manager for the American National Insurance Company, located in Galveston. From 1968 to 1976, I was the Development Fund Manager for the Texas Water Development Board, where I supervised the State bond program for water and sewer services. From 1976 through the present, I have been the Executive Director for the Municipal Advisory Council.

3. The Municipal Advisory Council, in the regular course of its business, maintains records of the number, kind, and size of all tax-exempt bond issues made in the State of Texas by State agencies and political subdivisions of the State. Attached to the Affidavit as Exhibit 1 is a summary of the tax-exempt bond issues made in the State of Texas during the period from January 1, 1982, through November 26, 1982. As this Exhibit reflects, fifty-seven percent of all issues were of sizes less than $2.5 million. Based on my knowledge and experience in the Texas bond business, I believe that the overwhelming majority of these tax-exempt issues were made by small political subdivision-issuers, including municipalities, school districts, hospital authorities, river authorities, and so forth.

4. Through both my position as Executive Director of the Municipal Advisory Council and my general knowledge of the Texas bond industry, I am aware of fees typically charged to issuers by paying agents. A "paying agent" is that entity, almost always a bank or other financial institution, designated by the issuer as its agent for the payment of principal and interest on the bonds to the bondholders. Attached to this Affidavit as Exhibit 2, in the third column from the left, are the average fees charged to issuers by Texas paying agents at the present time.

5. In my capacity as Executive Director of the Municipal Advisory Council, I am also involved with

representatives from all areas of the bond industry, including political subdivisions (in their capacity as issuers) and financial institutions (in their capacity as paying agents), in helping to gather information and develop guidelines for use in the implementation of the TEFRA bond registration requirement. Through such work as well as through my own experience in the industry, I believe that the projected fees set forth in the fourth column on Exhibit 2 are typical of the fees projected by Texas financial institutions that will serve as both the paying agent and the registrar for registered bonds. The reason that such large cost increases are projected is because of the enormous increases in computer equipment, paperwork and personnel necessary to handle fully registered bonds.

6. Because the bond registration requirement will most adversely affect small bond issues and because the majority of tax-exempt bond issues in Texas are small in size, the bond registration requirement will have a significant economic impact on political subdivisions in Texas issuing tax-exempt bonds.

7. Based on my experience in the bond business, I believe that issuers will pay increased interest rates in order to issue fully registered bonds. An increase in interest rates means that the issuers must make higher annual interest payments over the life of the bonds, resulting, for example, in higher taxes and service rates. An increase in interest rates also means difficulties for issuers ever issuing such bonds at all depending on bond market conditions at the time, for example, during a period of high interest rates.

8. Increased costs incurred by issuers that are associated with higher interest rates will be significantly higher that the increased costs resulting from the projected fees set forth in Exhibit 2. In 1982, by assuming only a slight one-half of one percent (½ of 1%) increase in interest rates per issue, the total increased interest costs to the issuers would exceed $20,000,000.

This figure is determined by multiplying the January-November 1982 volume, $4,369,565,000 (see Exhibit 1), times the one-half of one percent increase in interest rates.

I have personal knowledge of the facts alleged herein. I declare under penalty of perjury that the foregoing is true and correct.

Danny Burger

Subscribed and sworn to before me this the 30th day of March, 1983.

/s/ Gloria P. Carter

Notary Public in and for the State of Texas

My Commission Expires: Jan. 25, 1984

EXHIBIT 1
SUMMARY OF TAX-EXEMPT BOND ISSUES IN TEXAS
(January 1, 1982 - November 26, 1982)

Issue Size	Texas Issues	Volume of Bonds	Cumulative Percent of Issues
$ 1,000,000	196	$ 88,213,000	36.0%
2,500,000	127	215,730,000	57.0%
5,000,000	98	362,978,000	75.0%
7,500,000	42	266,443,000	82.0%
10,000,000	26	235,341,000	87.0%
25,000,000	46	740,860,000	95.0%
87,857,000*	28	2,460,000,000	100.0%
	563	$4,369,565,000	

*Average size based on volume divided by issues.

EXHIBIT 2

COMPARISON OF CURRENT PAYING AGENT FEES WITH PROJECTED PAYING AGENT/REGISTRAR FEES

Issue Size	Cumulative Percent of Issues (See Exhibit 1)	Current Annual Paying Agent Fees (Average)	Projected Annual Paying Agent/Registrar (Average)	Projected Annual Percent Increase in Fees
$1,000,000	36.0%	100	$2535.00	1435%
2,500,000	57.0%	200	2570.00	1185%
5,000,000	75.0%	400	2640.00	560%
7,500,000	82.0%	600	2780.00	363%
10,000,000	87.0%	800	3060.00	282%
25,000,000	95.0%	2000	5000.00	156%

STATE OF INDIANA)
)SS:
COUNTY OF MARION)

AFFIDAVIT

Fred L. Armstrong, being first duly sworn upon his oath, deposes and says:

1. That he is the duly appointed, qualified and acting Controller, the City of Indianapolis, Indiana, and as such is responsible for and oversees the issuance and sale of general obligation bonds of the City of Indianapolis and of the special taxing districts of the City.

2. That the payments of the principal of and the interest on general obligation bonds of the City and of its special taxing districts are secured by a pledge of ad valorem property taxes levied on property located within the City or within the special taxing districts as the case may be.

3. That in 1982 the Park District of the City of Indianapolis ("Park District"), a special taxing district comprising all of Marion County, Indiana, and empowered by state law to issue and sell general obligation bonds of the district for the purpose of financing park improvements, initiated proceedings for the issuance of Park District Bonds in the aggregate principal amount of $7,500,000 (the "Bonds").

4. That the Bonds were originally intended to be isssued in bearer form (as had all previous general obligation bonds of the City and its special taxing districts) until the passage by Congress of the Tax Equity and Fiscal Responsibility Act of 1982 (the "Act"), which Act, inter alia, requires such bonds to be issued in registered form in order for the interest on such bonds to be exempt from the federal income tax, whereupon the

Park District undertook such proceedings as would enable the Bonds to be sold as registered bonds.

5. That prior to the sale of the Bonds, Congress postponed the effective date of the mandatory registration provisions of the Act to July 1, 1983.

6. That the Park District chose to proceed to sell the Bonds in fully registered form rather than to incur additional costs and delays which would have been occasioned had the Park District decided to take further legal proceedings required to sell the bonds in bearer form.

7. That the Bonds were sold at public sale to the highest qualified bidder on January 26, 1983 at a price of par and bearing interest at a net effective average annual interest rate of 8.624754%.

8. That subsequent to the sale of the Bonds he learned that the fact that the Bonds were issued in fully registered form caused bidders for the Bonds to quote higher interest rates for the bonds than they would have quoted had the Bonds been issued in bearer form.

9. That he contacted City Securities Corporation through its Executive Vice-President, Mr. Richard DeBolt, and asked him to investigate and determine from the managers of the successful bidding account the amount of the increase in the interest cost to the City which was attributable to the fact that the Bonds had been issued in fully registered form.

10. That Mr. DeBolt reported his findings in a letter dated March 8, 1983, a true and accurate copy of which is attached hereto and incorporated herein by reference as Exhibit "A", and said letter demonstrates that the fact that the Bonds were issued in fully registered form rather than in bearer form resulted in an increased interest cost to the City of between 25 basis points (0.25%) and 50 basis points (0.50%).

11. That based upon the statements set forth in Exhibit "A" he has computed the dollar interest cost attributable to the fact that the Bonds were issued in fully registered form and he estimates that the taxpayers of the Park District will be forced to pay an additional $301,000 in interest costs over the 15 year life of the bond issue that they would not have had to pay if the Bonds had been issued in bearer form.

12. In addition to the increased interest costs associated with the registered Bonds, he has had to contract with a local bank to serve as registrar and paying agent on the Bonds, and he estimates that the average annual expense to the taxpayers for these services during the life of the bond issue will be $5,000 for a total of $75,000 for the fifteen year life of the Bonds.

Further affiant saith not.

/s/

Fred L. Armstrong
Controller, City of Indianapolis, Indiana

Subscribed and sworn to before me, a Notary Public, in and for said County and State this 30th day of March, 1983.

Signed /s/

Printed Shannon Thompson

NOTARY PUBLIC

County of Residence: Marion

My Commission Expires: October 14, 1984

EXHIBIT "A"

March 8, 1983

Mr. Fred Armstrong
City Controller
City-County Building
Indianapolis, IN. 46204

RE: $7,500,000 Indianapolis Park District
Fully Registered Bond Issue

Dear Fred:

I called the managers of the successful bidding account on this issue and asked them to comment on the difference in interest cost they believed existed between this registered issue and the cost if it had been issued in coupon form. The following comments were made:

> Randall Coleman, Vice President in charge of Underwriting, Smith Barney - Chicago (Lead Manager). Thought you were penalized 25 to 40 basis points. Probably closer to 40. A letter to this effect was written to you. He can be quoted.
>
> William Wingader, Vice President, Manager, Underwriting Dept., John Nuveeen & Company

(Co-manager). Cost to issuer a minimum of 25 but probably 40 basis points on original issue. The account sold the last 200,000 to 300,000 of the issue at a loss of 75 basis points which relates to a loss of about $60.00 per 1,000. He believes the registration was the reason the bonds had to be sold at a loss. He also stated that between the time the issue was purchased by the Smith Barney group and the sale of the remaining bonds, the market had improved by about 50 basis points which adds further to the adverse effect of the registrations. He can be quoted.

James Arkebauer, Vice President, Manager Underwriting Dept., First Wisconsin National Bank of Milwaukee (Co-Manager). They dropped from the account and did not bid on the issue because of the difficulty they have found in selling registered bonds. He stated he thought the registration cost the District at least 50 basis points. He also stated a State of Wisconsin registered issue trades in the secondary market at a 75 bais points penalty to the State's coupon issues. Also two City of Milwaukee General Obligation issues sold at the same time. One because the funds were to be used for housing, was required to be registered. The other sold in coupon form. The registered issue received a bid with a 25 basis point increase in cost to the City. Now in secondary market trading, the coupon issue sells at a 75 basis points premium above the registered issue. He can be quoted.

Edward Swanton, Vice President, National Underwriting Manager, Merrill Lynch White Weld Capital Markets Group, New York (Co-Manager). He did not want to be quoted but

finally admitted that he thought the registration cost the Park District about 25 basis points.

All these comments show that the Park District interest cost was substantially higher because the bonds were sold in fully registered form.

I hope this will be of some help to you. If I can be of further service, please call.

Sincerely,

Richard H. DeBolt
Executive Vice President

RHD/rsl

NO. 94 Original	TITLE South Carolina, Plaintiff v. Donald T. Regan, Secretary of the Treasury of the United States

DOCKETED	COURT
February 9, 1983	Motion for leave to file Bill of Complaint

DATE	PROCEEDINGS AND ORDERS
	Counsel for Plaintiff: Karen LeCraft Henderson
	Counsel for Defendant: Solicitor General
Feb. 9, 1983	Motion for leave to file and Bill of Complaint filed.
Apr. 8, 1983	Order extending time to file a response to the motion for leave to file a bill of complaint until May 11, 1983.
May 5, 1983	Brief, amici curiae, of Texas, Alaska, Arizona, et al. filed
May 10, 1983	Motion of plaintiff for preliminary injunction filed.
May 12, 1983	Brief for the Defendant in opposition filed.
May 16, 1983	DISTRIBUTED. 5-19. (Motion of plaintiff for preliminary injunction).
May 17, 1983	DISTRIBUTED. 6-2. (Motion for leave to file bill of complaint).
May 18, 1983	Reply brief of the Plaintiff filed. (D).
May 31, 1983	DISTRIBUTED. 6/2/83. (Motion for leave to file bill of complaint & Motion for preliminary injunction).
June 3, 1983	DISTRIBUTED. June 9, 1983. (Motion for leave to file a bill of complaint, also motion for preliminary injunction).
June 13, 1983	The motion for a preliminary injunction is DENIED. The motion for leave to file a bill of complaint is set for oral argument in due course.
July 8, 1983	CIRCULATED.
Aug. 17, 1983	Motion of Defendant for leave to file supplemental memorandum filed. (D)
Aug. 19, 1983	Motion of plaintiff and Texas for divided argument filed.
Aug. 15, 1983	SET FOR ARGUMENT. Wednesday, October 5, 1983 (1st case)
Sept. 9, 1983	Motion of plaintiff for leave to file supplemental memorandum filed.
Sept. 23, 1983	Motion of National Association of Counties, et al. for leave to file a brief as amici curiae filed.
Oct. 3, 1983	The motion of the defendant for leave to file a supplemental memorandum is GRANTED. The motion of the plaintiff for leave to file a supplemental memorandum is GRANTED. The motion of plaintiff and Texas for divided argument is GRANTED. The motion of National Association of Counties, et al. for leave to file a brief as amici curiae is GRANTED.

Title

No.

DATE	PROCEEDINGS AND ORDERS
Oct. 3, 1983	Motion of City of Baltimore, et al. for leave to file a brief as amici curiae filed.
Oct. 5, 1983	ARGUED.
Oct. 11, 1983	The motion of the City of Baltimore, et al. for leave to file a brief as amici curiae is GRANTED.